PRICE FLUCTUATIONS IN OIL MARKETS

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PRICE FLUCTUATIONS IN OIL MARKETS

THURSDAY, MARCH 9, 2000

HOUSE OF REPRESENTATIVES,
COMMITTEE ON COMMERCE,
SUBCOMMITTEE ON ENERGY AND POWER,
Washington, DC.

The subcommittee met, pursuant to notice, at 10:05 a.m., in room 2123, Rayburn House Office Building, Hon. Joe Barton (chairman) presiding.

Members present: Representatives Barton, Bilirakis, Largent, Burr, Norwood, Shimkus, Wilson, Shadegg, Fossella, Bryant, Boucher, Hall, McCarthy, Sawyer, Markey, Rush, Wynn, and Strickland.

Also present: Representative Greenwood.

Staff present: Cathy Van Way, majority counsel; Miriam Erickson, majority counsel; Elizabeth Brennan, legislative clerk; Sue Sheridan, minority counsel; and Rick Kessler, minority professional staff member.

Mr. BARTON. The Subcommittee on Energy and Power of the Energy and Commerce Committee hearing on Oil Price Fluctuations will please come to order.

I would like to welcome everybody to today's hearing. I believe it's going to be educational, and I hope that we will learn quite a bit about how oil markets work and their impact on the U.S. economy.

Before we begin, I would like to personally welcome our new ranking member, Congressman Rick Boucher of the great State of Virginia.

I have enjoyed working with Congressman Boucher on a number of other issues, and I look forward to working with you on the issues before this subcommittee for the remainder of this Congress.

I think everyone that knows Congressman Boucher knows that he's a very thoughtful legislator, and he pays close attention to the issues that he has responsibility for.

He does have some big shoes to fill. The great Congressman, Ralph Hall of Rockwall is a tough act to follow, but I'm sure that he'll be up to the task.

Congressman Hall is now the ranking member on the Science Committee, but he will remain a member of this subcommittee.

I'd like to take note of what a difference a year makes. Last Spring I was hearing daily from my independent producers down in Texas that the price of oil was too low.

The independent producers were shutting in wells, companies were going bankrupt, people were being laid off. Out in West

Texas, when they deducted for the cost of transportation, there were stripper well producers that were getting less than eight dollars a barrel for oil.

What a difference a year makes. Prices are now above $30 a barrel. Instead of hearing from oil producers, all of our colleagues that are before me are hearing from their oil consumers.

That's democracy, and there is absolutely nothing wrong with the communication channel in a democracy.

So the question arises, what, if anything, should we do, we, being the U.S. Congress and the Federal Government, about oil prices?

Since 1981 the price of oil has been deregulated, and has been set exclusively in the marketplace. Admittedly, the marketplace is not an open marketplace because as we all know, the OPEC cartel, most of which members have nationalized their oil production, does, for all intents and purposes, set the price.

The United States, however, has eliminated price and allocations controls for oil, recognizing that those policies had been failures and had resulted in shortages and gasoline lines.

Anybody in this room who is over 40 years old certainly remembers the gasoline lines of the late 1970's and early 1980's. Allowing the marketplace to set oil prices has resulted in more than adequate supply, and has resulted in lower prices.

However, unfortunately, one result of the price being set by the marketplace is that it does fluctuate. Just yesterday, for example, the price of oil dropped $2.85 a barrel, closing at $31.28 a barrel on the New York spot market.

In recent years, these price fluctuations have been in favor of consumers. I did not have one person call me last year, asking if the Government could do something about low oil prices, not one.

By and large, allowing oil markets to operate free of government intervention has worked, and even at today's prices, oil and the by-products that are refined from it is a bargain.

According to the Energy Information Administration, which we will hear from later today, in 1991, the price of oil, when adjusted for inflation to 2000 dollars, was over $70 a barrel, which is more than double today's price.

Considering the poor track record of the U.S. Government in trying to regulate oil prices, I, for one, do not believe that we should get back in the business of setting oil prices, even in a back-door fashion by drawing down the Strategic Petroleum Reserve as some have requested.

In addition to being against the Congressional intent and spirit of the law, it is just quite simply bad public policy.

I agree with former Secretary of Energy, James Schlesinger who said earlier this week, "... the Reserve was adopted for an entirely different reason—to help tide this country over in a supply cutoff—and to deter political blackmail. It was not intended as a short-term economic instrument to modify price swings. To use it would make the U.S. Government just another player in the oil market, adding another unpredictable element that would likely deter new company investment in exploration and production."

That's from Jim Schlesinger, the former Secretary of Energy in the Carter Administration.

I am also not a fan of investing money in a heating oil reserve in the Northeast as some have advocated, for basically the same reasons.

I do, however, believe that there are some things that we can do to address this problem. No one in this room wants higher and higher energy prices. If we're going to try to stabilize our energy infrastructure and our energy markets, we should be looking for ways to improve many areas.

For one, we could begin to add to and improve the natural gas infrastructure in this country, especially in the Northeast. Natural gas is a clean fuel; it's environmentally safe. We have adequate supplies in the United States. We could do much to improve and increase our production of clean-burning natural gas.

Second, we could at least consider to reduce, on a temporary basis, some of the Federal Excise taxes that we now have on energy products, such as fuel oil, diesel fuel, and jet fuel, perhaps even gasoline.

The gasoline Federal Gas Tax is 18.4 cents a gallon. Each penny of the gas tax is a billion dollars a year in revenue to the Federal Government.

Third, and most importantly, we need to focus on improving our energy base in this country by improving and increasing domestic production. If we really want to decrease our dependence upon foreign oil imports, and decrease our dependence on the quotas that OPEC sets, we need to offer whatever support we can to our independent oil and gas sector.

Our marginal-well producers should be kept operating as long as is possible. When oil prices hit their low last year, for example, many independents were forced to cease production from their marginal wells.

These are wells that produce less than 10 barrels as day. We lost, according to the Independent Petroleum Association of America, approximately 600,000 barrels of oil production per day in this country last year—600,000 barrels a day.

It's estimated right now on the world market that there is a shortage of somewhere between 1 million and 1.5 million barrels a day. Think what prices would be if we hadn't shut in those wells last year. This lost production would have certainly minimized the price spike that we've had this year.

We should also discuss environmentally safe ways to harness our Nation's natural resources in the outer continental shelf and in the Alaska National Wildlife Reserve. Producers have been unable to employ modern drilling technologies which are more efficient, less costly, and much more safe than such techniques were when those moratoria were put in place.

For example, we could have one drilling platform located right here at the Capitol, and it could drill all the wells that would be needed for the entire District of Columbia, going out into Maryland and also out into Virginia, one platform. That's how efficient and how effective our drilling technology is today.

So, if we really want to do something to stabilize prices, we should revisit the issue of exploration and production in areas that are currently off limits. I will be holding hearings later this year on just issues of that nature.

I am not a supporter of regulating the price of energy, but I am a supporter of developing a coherent national energy policy that minimizes dependence and maximizes the independence of the United States economy.

I look forward to hearing the testimony of the witnesses before us. I would now recognize my ranking member, Mr. Boucher of Virginia for an opening statement.

Mr. BOUCHER. Mr. Chairman, thank you very much for your kind words of welcome and your kind comments. I very much look forward to our work together, and in the pursuit of sound energy policy.

I want to commend you, Mr. Chairman, for scheduling the hearing this morning on a very timely subject. Our colleagues who represent the Northeast have large numbers of constituents who rely on oil for home heating.

They have experienced tremendous financial pressures as the price of heating oil has increased this year by approximately 80 cents per gallon, a 66 percent increase from previous levels.

In rural America, our concerns are also large. I represent a rural Congressional District. It has 23 counties and cities.

It's not uncommon for many of my constituents to drive as much as 50 miles in each direction to go to work. I have a lot of those constituents who are saying that they can no longer afford those long drives, given the rapid increase in gasoline prices.

And some people in rural America are now even looking for other work so that they can be closer to home. And while they will earn less, at least at the end of the week, they take home more.

We're all concerned about the effect on our national economy of the dramatic increase in the price of crude oil from approximately $12 per barrel this time last year, to more than $30 per barrel at times this year.

Mr. Chairman, I am also very concerned about our Nation's unhealthy reliance on oil imports. We currently rely on foreign oil producers for approximately 50 percent of the oil that we consume in this Nation.

The Department of Energy has predicted that current trends suggest that in the absence of some rather significant policy changes, over the course of the next two decades, our reliance on foreign oil imports will rise, and that in the year 2020, we'll be importing approximately 65 percent of all of the oil that we consume, from foreign nations.

The best way to guard against the fluctuations of future world oil prices, the best way to prevent in future years, the kind of financial pain that many of our constituents are feeling today, the best way to assure future oil price stability is to enhance American energy self reliance.

We're a Nation rich in resources and rich in technical expertise. We can become more energy self-sufficient. But to do so is going to require a national commitment to that cause.

Given the problems that we face today, I think the time for that commitment is at hand.

Finally this morning, I want to say a word of thanks and a word of congratulations to the Administration for the steps that it has taken to address the current financial pain felt by millions of Americans.

Secretary Richardson has personally urged the leaders of oil-producing nations to increase production levels, and a number of nations have indicated their intention to seek higher oil production quotas later this month. The results of his diplomacy are self evident.

The President has released all of the funds available in the Low-Income Home Energy Assistance Program in order to assist in relieving the financial pressures people are feeling for home heating.

The Federal Trade Commission is working actively with the Attorneys General of the States to investigate whether increases in oil prices arise, at least in part, from anticompetitive conduct anywhere in the supply chain.

And the Administration is working with the States to obtain waivers under the Clean Air Act, where appropriate, to ensure adequate energy production levels.

These are commendable steps. This morning, I'm sure our subcommittee will hear recommendations for other steps that should be considered, and I join with you, Mr. Chairman, in looking forward to the testimony of these witnesses.

Mr. BARTON. Thank you, Congressman Boucher. We'd now like to recognize Congressman Bryant for an opening statement.

Mr. BRYANT. Thank you, Mr. Chairman. I appreciate very much, you holding this very timely hearing, and I want to thank our distinguished witnesses for appearing today, especially our colleagues in Congress.

I'm eager to hear the thoughts and recommendations on this issue that they have, and I would simply concur with what both of you have already said today in terms of concerns that I have.

But in addition to that, I want to say that a few weeks ago, over 400 heavy trucks and tractor trailers came to the Capitol to try to raise the Nation's awareness of the escalating price of fuel.

For these drivers, many of whom are independent businessmen and women, this was about more than simply paying a few more dollars at the pump; their trip here was about sending a message to Washington's policymakers that the future of their business was at stake.

Fuel is often the second highest expense for truckers, and that dramatic price increase has forced many to simply park their trucks or even surrender their trucks, rather than lose money on each haul because of the high price of fuel.

We certainly have this occurring back in Tennessee, and I know it's occurring across the country. The average American driver is like the rest of us, though; we're also feeling the effects of the steep prices.

But these implications of high fuel prices for us go far beyond the increased cost of filling our gasoline tanks. The vast bulk of our Nation's goods are being transported by the trucking industry, and as the transportation costs rise, obviously, businesses are going to be forced to raise the price of their goods and pass those on to us as consumers.

So, in practical terms, this means that not only will a mother have to pay more to drive to the local grocery store and to take the kids to school, but she will also have to confront an increase in the price of milk and eggs and vegetables at the grocery store.

Fuel prices have recently shot up, I believe, because member countries of OPEC have agreed to artificially raise the price of oil by limiting production. Due to OPEC's actions, prices have gone from $11 to $12 a barrel in December 1998, to a high of $30 a barrel in mid-February of this year, levels not seen since the Persian Gulf conflict.

A columnist in yesterday's Washington Post argued that Washington should not overreact to high fuel prices and should allow the free market to set the fuel prices. I believe in a free market, and I agree that Americans do not have a right to cheap gasoline, but the free market is being manipulated, and Congress should not have to apologize for considering policies to counter the foreign collusion.

Short of legislative solutions, President Clinton can, and I think should, use better diplomatic resources that are available to him to put pressure on OPEC member nations to increase their production.

In fact, many of the Americans currently suffering from OPEC's manipulation of global supplies are veterans of the Gulf War who risked their lives to liberate and defend the oil-producing states, states which are now conspiring to keep prices artificially high.

I think the President has an obligation to use the power associated with his office to convey the U.S. disapproval of OPEC's supply strategy.

And I think this should have been not as a reaction that we're looking at right now where all of a sudden we're doing it, this should have been a long time ago. This didn't happen just simply overnight. And that's my concern, that we're going to have to go through this crisis when we could have had better diplomatic relations in anticipation in a preventative measure, rather than reacting and running over there and asking them, oh, please, lower your prices. I just disagree with this policy.

As a footnote, I want to also, since we have some distinguished panelists, I want to know more about how prices are set in this country. It concerns me when I'm back home buying gas, and I see the price go up or down, and it seems to be tied together. I know it's against the law to conspire, and I know people aren't conspiring, but every price goes up about the same when they go up, and it goes down about the same.

And I understand that competition drives it down sometimes, but I'm concerned about the prices going up together at the same time, as well as the other one. I haven't figured out yet—I know gasoline is delivered to the retailers' service stations, not every day. But yet every day, the prices seem to be going up and down.

And this argument that, well, you know, I have to raise my price because when they bring gasoline in, it's gone up. But I see them going up and down—mainly up now—every day, and I know they're not getting resupplied every day.

And I just wonder how they can justify that type of price increase on that argument, well, my prices are going up.

Maybe somebody can educate me on that today. I look forward to that, and I thank, again, the chairman for holding this hearing, and look forward to learning a lot about what's going on today. Thank you.

Mr. BARTON. I thank the gentleman from Tennessee. We now recognize the distinguished gentleman from Massachusetts, Mr. Markey, for an opening statement.

Mr. MARKEY. Thank you, Mr. Chairman, very much. You know, I know that many like me are inspired by the eloquent odes to the free market and the dire warnings about the catastrophic consequences of any governmental intervention into the operation of the marketplace.

And I wonder just where all of those spokespeople were last March when the subcommittee held a hearing just upstairs to pressure the Administration to block additional sales of Iraqi oil under the Oil for Food Program because many members from oil-producing regions felt that oil prices were too low, and they wanted to drive these prices back up.

Where were all these opponents of governmental intervention into the markets last October when this committee approved H.R. 2884, the Energy Policy and Conservation Act Reauthorization Bill, which included a provision directing the Department of Energy to purchase oil from marginal stripper wells in the United States whenever the price dropped below $15 a barrel? That's not the free market; that's the government intervening.

Now, for most of my constituents up in Massachusetts, the stripper well sounds like something you used find down in a section of Boston we referred to as the Combat Zone, but this committee decided last Fall that it was so important to protect stripper wells from threat of low oil prices that we had to set up a special little welfare program for them.

But now that oil prices are too high, and consumers in the Northeast and across the country are suffering from gasoline prices, now what are we going to do? Are we going to actually get the Administration to use its existing legal authority to deploy the Strategic Petroleum Reserve? Are we going to get around to creating a regional refined product reserve that could quickly be deployed in the Northeast when we face energy emergencies?

No. We're told that would be wrong. That would be interfering in the operation of a free market, and we just couldn't do that, because that would only be protecting consumers, not the oil industry.

Well, the fundamental fact of the world oil market is that it is not a free market. Much of the supply is controlled by the OPEC oil cartel. OPEC governments meet to set production quotas and establish target prices, not the hidden hand of the free market.

Now, OPEC and the Cato Institute might believe that that's a free market, but they're the only people who believe that that is a free market.

So, if it is acceptable to the U.S. Government to intervene when prices are too low for the producer states, which is what this subcommittee apparently thinks, because that is just what H.R. 2884 does, why is not also acceptable for the government to intervene when oil prices are too high and consumers are being harmed?

Ten years ago, I joined with Representatives Moorehead and Lent, Republicans, to offer an amendment to the Energy Policy and

Conservation Act which would create, on an interim basis, a federally sponsored regional storage facility for petroleum products.

Our amendment, which was signed into law in September 1990 as Section 160(g) of the Act, would have mandated that DOE set up a regional refined products reserve on a test basis. The Bush Administration's Department of Energy then completely disregarded the direction of Congress that the regional reserve be located in those areas of the country such as the Northeast that were most dependent upon imported petroleum products or likely to experience shortages of refined petroleum products.

Instead, they proposed to set up the regional refined reserve using existing facilities on the Gulf Coast. And then to add insult to injury, the Bush Department of Energy then refused to spend any money on the program.

I wish I could say that the Clinton Administration Department of Energy had corrected the problem, but it didn't. It failed to insist that Congress appropriate funding for the program between 1994 and 1995 and then it walked away from the program.

In 1996 when we were experiencing an earlier round of high oil prices, the Department actually undertook a paper study of the desirability, feasibility and cost of creating a regional refined product reserve, and even this study, which I think understates the matter, was forced to conclude that the benefits of a 2 million barrel refined product petroleum reserve located in leased terminals in the Northeast would approximate or exceed its costs, provided that the costs would be reduced by trading Strategic Petroleum Reserve crude oil for distillate fuel.

Despite this favorable conclusion, the Department subsequently took the official position that a government-owned and controlled crude oil reserve located in the Gulf Coast region is the most cost-effective way to ensure continued oil products to the Nation during a severe oil supply interruption.

In other words, no regional refined product reserve in the northeastern part of our country. Indeed, last September 23, the Department's Assistant Secretary for Fossil Energy actually testified before this subcommittee that the Administration wished to delete unused provisions of the law that provide for the establishment of regional and industrial petroleum reserves.

Unused? I'll say they're unused. These provisions are unused because neither this Administration nor the Bush Administration ever bothered to make use of them.

Indeed, DOE has chosen to disregard and ignore the problem. And so I look forward to hearing from the Department this morning about the lessons of this Winter's home heating oil crisis. Perhaps now we will take action.

And I look forward to hearing from the other witnesses, and I thank you, Mr. Chairman, for holding this hearing.

Mr. BARTON. Thank you, Mr. Markey. I'm sure that you'll invite me up to Boston and I can ask your constituents if they want gasoline refined from $15 a barrel Texas crude oil or $30 a barrel Saudi Arabia crude oil and most of them will vote for $15 a barrel Texas crude oil. I just have a suspicion of that, but I could be wrong.

Mr. MARKEY. I think that when people go up to their gas station they don't ask where it is coming from, they just ask how much does it cost, and when it's heading toward two bucks a gallon they are not going to be too choosy and say I would rather pay a higher price if it came from America. They just want to make sure it is there.

Mr. BARTON. Well, democracy is a wonderful thing and you and I together will solve this problem, I'm sure.

Mr. MARKEY. This committee wouldn't be interesting if Texas and Massachusetts wasn't as fully represented as they are.

Mr. BARTON. That's true. Now let's hear from Congressman Largent of the great State of Oklahoma for an opening statement.

Mr. LARGENT. Mr. Chairman, I commend you for holding this hearing this morning to examine a cause and effect of recent price fluctuations in the world's oil markets. Unfortunately it is not until we experience sticker shock at the gas pump where American families have to pay significantly higher prices to heat their homes that oil and gas enter the national consciousness.

Now that the matter has raised national interest I hope that the Administration and Congress will genuinely focus on developing a long-term energy policy based on self-reliance, one that promotes domestic oil and gas exploration and production, rather than directing our efforts on some short-term band-aid fix that may help in the short-term but ultimately does little to prevent future price fluctuations.

In short, we need to stop treating the symptoms and find a cure.

As one who represents an oil-producing State I know all too well the economic havoc as well as the national security threat that stems from our reliance on foreign oil imports. Since 1985 domestic crude oil production has declined while our oil consumption has increased. Today the U.S. imports over 55 percent of our crude to meet domestic demand. Common sense would dictate that as demand grows so should our production. Unfortunately, this is not the case.

In fact, during the last 2 years our domestic oil industry has lost 65,000 jobs. These jobs have been lost for a variety of reasons—a tax policy that favors investment overseas rather than here at home, a growing regulatory burden which has significantly increased industry's compliance cost to the tune of $90 billion over the past decade, offshore drilling moratoriums that prevent environmentally safe development of domestic resources off our coasts, and the refusal to even consider whether to open the Arctic National Wildlife Refuge Coastal Plane for oil and natural gas development.

Mr. Chairman, we can talk about whether or not we should release the Strategic Petroleum Reserve, why OPEC and non-OPEC producing companies decided to cut back on their production, whether or not there has been anticompetitive behavior, or whether or not we should create a strategic reserve for heating oil, but in my opinion the focus of this hearing as well as the focus of policymakers needs to be on what we must do to stimulate domestic exploration and production. Otherwise I predict we will continue to have these large price spikes which will result with future Secretaries of Energy traveling the globe on bended knee asking foreign countries to please meet our energy needs.

I look forward to hearing our witnesses' comments. Thank you, Mr. Chairman.

Mr. BARTON. Thank you, Mr. Largent. We would now like to hear from the former ranking member and a member whose district includes the East Texas oil patch, Congressman Ralph Hall of Texas.

Mr. HALL. Mr. Chairman, thank you very much and I join the accolades for holding this hearing. It is very timely. A lot of attention has been focused on the rapid rise in heating oil prices and I am sympathetic to that, particularly for the people in the Northeast. Higher product prices for heating oil, diesel fuel and gasoline have been felt in other parts of the country as well.

You know, before Mr. Boucher moved closer to the chairman's desk up there, I always got to talk before Markey talked and that was both good and bad but I think I just have to answer my friend from Massachusetts in that it is not that prices are too low for energy, because all of us want reasonable prices, but they are too unreliable and if we could get a steady price—something acceptable that was steady where little guys could go borrow it to drill a hole and then sell it to the big guys, and that's the way it works, I think we could help you solve the problem of heating oil in the North and East.

We're not unsympathetic to that. I certainly am not, but I don't hear my friend from Boston complaining about Amtrak—the dang thing goes I think 38 times from here to New York, 36 times to Philadelphia, I don't know how many times to Boston subsidized. The thing doesn't even whistle west of the Mississippi or slow down going through my little hometown, but still I support railroads because in a national emergency we operate on railroads and we have to travel by rail and it is important for those people in the Northeast Corridor with the population, heavy population, and in New York and those areas that they have transportation.

We are one Nation and we have different needs. We have different needs today to where there might be an answer that would help both of us very much. The problem of the oil market is that OPEC can get more oil out of one hole than we can get out of a hundred here. We have had no government protection and yet we are too proud to ask for a lot of Government protection, but the Government could be a little kinder to the energy operation. We don't need any energy policy other than a simple energy policy that says that there's some reward for getting it and then send you to look for it. That is what we really need and that is what we really want and that is what we have not really had in years and years.

I think in my district farmers and truckers have been squeezed dramatically and I realize that this gentleman from Massachusetts does an excellent job for the people he represents, and that we have different constituencies and we must make different speeches up here, but really and truly I think both of us want the same thing. That is an answer to what Jeremy Bentham called the greatest good for the greatest number. Energy is so important so why can't it like railroads and be a national asset and be considered as a national asset.

In my district we have been squeezed. Independent truckers do not operate a high profit business. Theirs is a low profit business and for independent truckers, the effects of increases on fuel is disastrous to them. Farmers in my area, already hit hard by a draught, are attempting to cope with higher fuel prices while their incomes have fallen dramatically. The Right to Farm Act that we passed some time ago that affects my district a little more than the Boston area. Any of you that have agriculture, any of us here who represent people that have agriculture the Right to Farm Act is going to wind up in about 2 years. The 7 year period is going to be over—and if the subsidies get pulled back and they don't have that thing called parity, which is not in that act anywhere, right, side, nor forehand, they are going to have a Right to Starve Act if this Government does not move in and do something to change that——

Mr. BARTON. Would the gentleman from Texas yield? I hate to interrupt his——

Mr. HALL. I am going so good——

Mr. BARTON. I know you are.

Mr. HALL. You never did stop me when I was sitting that close to you.

Mr. BARTON. Well, I am sorry. I will make it up to you, I promise.

Mr. HALL. All right.

Mr. BARTON. I just want our witnesses and the members of the panel that have not yet given their opening statements to know. We have two votes pending on the floor. We have a vote on a resolution. There is late-arriving news here.

We have a 15-minute vote, a 5-minute vote, and then a general vote to follow, so unfortunately I am going to have to suspend the hearing.

I would like to get Mr. Hall's opening statement and perhaps Mr. Shimkus's opening statement and then we will suspend to go vote, so I will now again recognize Mr. Hall.

Mr. HALL. Well, I just think amid all the allegations of one thing I believe consumers and producers can agree on is a goal that we ought to find a way to achieve some stable oil prices. All of us crave some certainty in the price of basic goods and services and no one is well served over the long term by huge fluctuations in the market. That is what the major problem is.

We are embarking on answers. I don't have one today, but I am interested in hearing what our witnesses have to say and maybe some ideas will come out of this and a way to work things. I yield back my time——

Mr. MARKEY. Mr. Chairman——

Mr. HALL. Yes, I do yield.

Mr. MARKEY. I would just like to say that I agree with you. I think the Northeast should work with the Southwest when the prices are too low, right?—and I would hope that the Southwest could work with the Northeast when the prices are too high, so that we can find some equilibrium.

Mr. BARTON. Isn't brotherly love great? I just love this. We are in the opening statements and already we are bonding here.

But unfortunately we have two pending votes. The Chair is going to recognize Mr. Shimkus for his opening statement, then we will suspend, but we are going to have three votes on the floor and as soon as the last vote is, the chairman intends to come back. We will recognize members that are present for opening statements, but if a member is not present for an opening statement we will then get to our first panel.

The gentleman from Illinois.

Mr. SHIMKUS. Thank you, Mr. Chairman. I will be brief and cut through a lot of the gobbledegook and just talk about in the national energy portfolio one thing that you left out and I will list it in No. 4 on your list is a credible, reliable biofuels program, one that the Administration talked about.

I have a bill, H.R. 2788, which would expand the CMAC. We had a hearing last week on the auctioner program. It was stated by the DOE, who is testifying today, that if we eliminated the auctioner program, gas prices would increase 3 to 5 cents a gallon. A credible biofuels program is critical to our national security. It decreases our reliance on foreign oil. It is cleaner burning and it is renewable. Any discussion on energy policy without considering the biofuels program is a mistake and obviously I will be in this process fighting for cleaner air, renewable source of fuel, and for our farmers, and I yield back my time.

Mr. BARTON. We are going to suspend the hearing. We have three votes on the floor. My guess is we will restart between 11:20 and 11:30, so the subcommittee is in recess until approximately that time.

[Brief recess.]

Mr. BARTON. The subcommittee will come to order. We are still in opening statements. We have members present.

The Chair would recognize Mr. Norwood for an opening statement and then he'll recognize Congresswoman McCarthy for an opening statement. Mr. Norwood.

Mr. NORWOOD. Thank you very much, Mr. Chairman. I do appreciate you having this hearing today. It is very timely and I thank our colleagues for taking the time and coming to testify.

I think it is fair to say that all areas of this country are feeling the effects of the recent near-historically oil and gas price increases. It is not just Boston. The unusually harsh, cold spell in January and early February over much of the East Coast, combined with OPEC's shenanigans, have made it extremely hard on many citizens, especially older Americans.

Mr. Chairman, I firmly believe that this crisis could and should have been avoided, and I lay the blame for allowing prices to get out of control squarely at the feet of the current Administration. This oil shortage is completely and wholly artificial. There is plenty of oil to go around if the oil-producing countries simply choose to pump it. If we had a President with enough intestinal fortitude to face down that same OPEC group that we baled out earlier last decade I do not think we would be in this mess.

Furthermore, I am deeply disturbed by remarks made by President Clinton on Tuesday that suggest he may be complicit in the artificial price hike. The President said that the prices need to be high in order to, and I quote, ladies and gentleman, "encourage the use of alternative fuels and to prevent global warming."

Now Mr. Chairman, I find that a little offensive. We do not need to be furthering the Clinton-Gore Administration's liberal global environmental wacko agenda on the backs of the American working poor and elderly. Our gas and oil prices do not hurt the new wealthy elite who have profited so well from the stock market, international trade and the boom in technology. If you are riding in a $60,000 Mercedes you probably do not give a rip whether gas is 89 cents or $1.89, but Mr. Chairman, my people are riding in used Fords and Chevrolets working two jobs to make up for the manufacturing jobs lost by NAFTA and the Red Chinese Army and I'll be durned if we ought to let the oil producing countries take their lunch money to boot.

Mr. Chairman, we need to send a strong message today gas prices last year in this country were not too cheap. We need this Administration to use every possible economic weapon at our disposal to bring these prices down before cumulative inflationary effect pulls our overall economy into recession.

If this Administration wants to pass new environmental legislation to stop people from using their cars to get to work or take their children to school, then bring the bill forward and let us have a debate on it today, but do not try to circumvent the will of the people by encouraging foreign nations to raise prices on our poor, then declare it is for their own good.

Mr. Chairman, I am anxious about this hearing. I look forward to it, and again I thank you for calling it.

Mr. BARTON. Thank you, Congress. We will put you down as undecided on what to do about the problem.

We would now like to hear from the gentlelady from Missouri, Congresswoman McCarthy, for an opening statement.

Ms. MCCARTHY. Thank you very much, Mr. Chairman.

I was not present when Mr. Shimkus gave his remarks with regard to biodiesel fuel, something that this committee helped to put into law and is hopefully creating relief in our transportation sector, but as I read the briefing that the staff provided about today's oil prices, they note that while crude oil prices have risen in nominal terms when adjusted for inflation they are still lower than historical prices. In today's dollars prices for crude oil peaked in 1981 at about $70 per barrel or $39 per barrel in nominal terms. Heating oil prices are also still lower than previous years, and yet we are experiencing in our country some distress in certain sectors and regions and certainly at certain economic levels, so I would hope, Mr. Chairman, that we would go forward on two fronts.

First of all, take a look at what other things we can be doing, such as this committee has done, to encourage uses of alternative fuels such as biodiesel and other fuel combinations that use our natural resources. Since the transportation sector is the largest petroleum end user, I think we might also explore whether or not what OPEC is doing is actually legal within the WTO and if not take steps to address that as well.

I do thank you, Mr. Chairman, for holding this hearing and for allowing us this opportunity to hear from members and also experts in the field and to have a full and fair discussion of what we as a Congress might do. Thank you very much.

Mr. BARTON. Thank you, Congresswoman. We appreciate that.

I would now like to hear from the distinguished chairman of the Health and Environment Subcommittee who shares some jurisdiction on this issue, Congressman Bilirakis of the great State of Florida.

Mr. BILIRAKIS. Thank you very much, Mr. Chairman, and I, too, commend you for holding this hearing.

Mr. Chairman, in yesterday's St. Petersburg Times there is an article entitled "Survey Confirms Gas Pump Shock." There is a paragraph in here: "The AAA usually conducts its price survey on a monthly basis but prices have been rising so fast lately that the organization will begin conducting weekly surveys March 14. The weekly schedule will continue at least through March 27, the next time members of the Organization of Petroleum Exporting Countries meet to discuss whether they will pump out more oil."

I think that basically says it all so very well, Mr. Chairman. We know about the gas prices having gone up and in Florida prices have gone up 15 cents a gallon in just 3 weeks. The average price for a self-service gallon of regular unleaded fuel reached $1.54 on Tuesday, up from $1.39 on February 15. A year ago a gallon of gas cost just 98.2 cents in Florida and earlier this week the Energy Information Agency predicted that even barring major refinery disruptions this summer average retail gasoline prices could reach a monthly average of $1.75 to $1.80 per gallon, and in high cost areas such as California prices could be as high as $2 per gallon.

Mr. Chairman, you and others have all said it. Finding the cure is really what we should be doing hopefully in this committee, and not just short-term fixes that we read about what the Administration is doing when their Department of Energy News announces "Administration's Actions to Ease Home Heating Oil Crisis." I would like to say that there are an awful lot of things they could be doing on a regular basis to keep the problem from taking place rather than after something like this comes up. Mr. Chairman, it is critical I think to go into the real reasons why the prices have gone up.

We can blame OPEC and OPEC to a large degree probably is responsible. I don't know how much of the responsibility lies really domestically, but knowing you and knowing your persistence and perseverance I think you are going to come up with the answers ultimately. Thank you, sir.

Mr. BARTON. Thank you, Congressman Bilirakis. We appreciate that.

The gentleman from Ohio, Mr. Strickland, is recognize for a brief opening statement.

Mr. STRICKLAND. Thank you, Mr. Chairman. I am pleased that we are holding this hearing today because the high price of gasoline and fuel oil deserves our full attention.

I represent a very rural part of Ohio, and just recently in recent days I have met with independent truckers, I have met with members of the Farm Bureau, and other constituents across Southern Ohio to hear the concerns that these hard-working individuals have.

Many of these people maintain business or farm operations which simply cannot withstand the recent volatility in the prices of diesel fuel, gasoline, and home heating oil. In rural Southern Ohio the considerable increase in fuel prices has alarmed many and they are looking to us to provide some stability during this emergency.

I think we must take our responsibility very seriously and explore thoughtfully and thoroughly our options for addressing this alarming situation, including the release of oil from the Strategic Petroleum Reserve.

I understand that the Administration has made no decision as to whether or not to pursue this particular option, but I emphasize that for many people in my district the high fuel costs have already created an economic crisis for them, and while we are sharing the blame for this current crisis, I think we should remind our so-called international friends that friendship is a two-way street.

We went to Mexico and helped them when they were experiencing economic difficulty and yet they have colluded, in my judgment, with OPEC including Venezuela and Saudi Arabia and Kuwait, a country where we put our national resources and the lives of our young people on the line, and now they collude to raise prices, and I think we should take the firmest stand with the OPEC nations.

I understand that we don't give them a lot in terms of direct economic aid, but we give them security, and Saudi Arabia is awfully glad that we exist, otherwise they may not exist and I think we should remind them of these circumstances and demand that they be sensitive to the needs of our economy as we face this very difficult set of circumstances.

Thank you, Mr. Chairman. I yield back my time.

Mr. BARTON. Thank you, Congressman, and your point about Mexico I think is very well taken.

I am glad that you brought that up, because that is worthy of future discussion.

The gentleman from the Tarheel State, the Honorable Mr. Burr of North Carolina.

Mr. BURR. Thank you, Mr. Chairman, thank you for this hearing. I welcome my colleagues. I had the opportunity to have Secretary Richardson in International Relations last week. Wish I could tell you that I was enlightened and knew that there was an end to the current process from his statement and answers but in fact I got the distinct impression that we still have no policy. For an issue that most Americans have seen coming for some time, the question is who was asleep at the helm.

Let me take this opportunity, Mr. Chairman, as you know I exercise frequently when individuals don't share with us the opportunity to read their testimony well in advance, that for an issue of this magnitude that affects so many Americans—seniors, truckers, the average person every time they stop at the pump—EIA and the Department of Energy was nice enough to share their testimony for this hearing with us at 8:30 p.m. last night. Under the rules of this committee we could deny them the opportunity to testify and I question today after reading the testimony last night whether it is even worth hearing, but this committee has never denied a branch of the Government the opportunity to come before us and educate us, enlighten us, and share with America what their plans were to solve the problem.

Clearly there was an opportunity for both to share their testimony with each other to make sure that there were no discrepancies between how they would testify.

I just had the opportunity to refresh myself with a letter or the response to a letter that I wrote to the EIA earlier with a number of other members, Republican and Democrat. Let me read one sentence in that letter: "EIA's latest projections show regular gas prices peaking near $1.40 per gallon this summer." That was in the last several weeks. Think of the gas pump price the last time you filled up. Clearly we have missed it again.

We have no better determination of where gas prices are going to go because we have no policy to stabilize it. I think my chairman of the Health Committee was right. It is time we find a solution. It is time that the Congress and the Administration work together. If using SPR to stabilize the price is an option, we have used it before. We should put it on the table now. How difficult a decision does the Administration have to make a determination as to what is an effective way to stabilize price?

I am reminded of the remarks that Senator Murkowski said this week or last week in his hearings. It is odd at a time where we are faced with this crisis that we have an Administration who is aggressively causes the price of electricity to go up through the regulations on the industry, has cutoff new exploration in the areas of the public Federal lands for exploration, and an Administration that blocks the Nuclear Waste Policy Act which affects the long-term cost and unpredictability of energy as well as our inability to relicense hydro facilities.

Mr. Chairman, this is an important hearing I thank you for holding and I yield back.

Mr. BARTON. I thank the gentleman from North Carolina. I would agree with the gentleman on the tardiness of some of the testimony. I was tempted to not let DOE testify today, but this is such an important hearing that I think we have to have their testimony in the record but it is ironic to me that they testified at a similar hearing in the Senate 2 weeks ago, so that I doubt that they had to reinvent every paragraph.

I just have a feeling that some of what their testimony today is is similar to what it was 2 weeks ago, so I share your concerns and I will be addressing them with the Secretary or his deputy later today, I hope.

We do have several more opening statements, but Mr. Sweeney has a pending engagement at 11:30, so we are going to attempt to expedite these opening statements.

The distinguished gentleman from Illinois, Mr. Rush, who I am sure his constituency has experienced more than most of our constituencies the pain of some of these higher energy prices recently, will be recognized for an opening statement.

Mr. RUSH. Thank you, Mr. Chairman, and you are absolutely correct. My constituency has faced many, many problems as it relates to the escalating prices, oil prices, and I want to thank you for calling today's hearing on the issue of oil price fluctuations.

I especially think it is important that our subject for hearing this morning is just not the high price of gasoline at the pumps or the price of heating oil this winter. Really our hearing must focus on the volatility of our markets. Just a year ago crude oil was selling for approximately $11 a barrel. Today it is selling for $30 a barrel. Now we certainly all understand how the free market economy works. When supply is high and demand is low, prices will fall. When supply is low and demand is high, as we know, prices will rise.

That said, my issue is not with the free market economy. My issue is with how we have allowed ourselves and our Nation to be manipulated by it.

During the first session of this Congress, this subcommittee held hearings on what could be done to assist domestic oil producers to keep their wells open. Situations like the one we face today was used as an argument for giving assistance to domestic producers. In response to today's high prices, the Administration appropriately took action by releasing LIHEAP funding for the lower income. Additionally, the Administration waived on a case by case basis certain environmental standards and currently on the Hill there is discussion of dropping the Federal gasoline tax.

That said, Mr. Chairman, these proposed remedies are not remedies to solve the issue of price fluctuation and our Nation's vulnerability to such fluctuations. Really what we must be about today and what we must be about when prices come back down is figuring out a way to decrease our Nation's vulnerability to fluctuating prices. We are present here at the dawn of the 21st Century. We are seeing technology that our parents and grandparents never dreamed of, and, Mr. Chairman, I find it hard to believe that in this day and age American cannot find a workable solution to oil price fluctuation.

What is the solution? Well, we are not sure at this point, but maybe perhaps there must be a greater focus on the use of renewable energies. Maybe we should be looking at natural gas more closely. Perhaps we should increase our reliance on domestic production and maybe we need to rethink our heavy reliance on foreign oil. Quite frankly, I am not sure of the solution.

However, I am certain that a quick fix today does not solve the problem tomorrow. Therefore, I am calling on the Congress and this subcommittee to work to solve this problem permanently—no quick fixes.

Let us set up commissions, conduct studies, do whatever that we must do to prevent our Nation's vulnerability to fluctuating oil prices. This must be done to protect our Nation's economy and to protect our Nation's security.

So Mr. Chairman, I fully appreciate the subject of today's hearing, but we must be about finding a permanent solution and not quick fixes, and with that, Mr. Chairman, I yield back the balance of my time.

Mr. BARTON. We thank the gentleman from Illinois for his thoughtful statement. We would like to now recognize the gentleman from Staten Island and part of Brooklyn, the baseball standout from the 13th District who is celebrating I am told today his 35th birthday, which means he is now eligible to run for President of the United States of America if he so wishes—Mr. Vito Fossella.

Mr. FOSSELLA. Well, thank you very much, Mr. Chairman.

Mr. BARTON. Is it not true it is your birthday?

Mr. FOSSELLA. This is true.

Mr. BARTON. It is true?

Mr. FOSSELLA. As to the second, I decline.

Thank you very much and thank you as always for holding the hearing.

I think the last thing we need today, Mr. Chairman, the American people need today is another analysis as to why prices have run up. I think what the American people need are answers as to what this Administration and Members of Congress who have been resistent to allow greater emphasis on domestic oil producers and create of a dependency on a foreign cartel.

I think if anything has come out of this hearing in the opening statements so far is that both sides of the aisle agree that the United States is too dependent on foreign cartels and there are things that this Administration can be doing to ease the regulatory burden on domestic oil producers to ease the tax burden and to create incentives so that we are less reliant upon this cartel.

We have seen in the last several months those constituents of mine in Staten Island, Brooklyn, what the consequence of lack of action are. Yesterday on Staten Island at the pump, $1.99 for gasoline. We have a gentleman with us today, Mr. Peter D'Arco, who supplies home heating oil to a lot of people in my district, and he will tell you first-hand what happened when we saw that spike in home heating oil just a couple of months ago. A lot of citizens on fixed income are not going to be able to pay their bill.

That is the consequence of lack of action, and I know a lot of people call for long-term solutions. Some people have called for commissions and studies. I don't think we need a commission. I think what we need is an articulate policy that says these tax burdens are too high, these regulatory burdens are too great, and then ultimately the constituents on Staten Island, my constituents in Staten Island, Brooklyn, will benefit and we will have a rational policy for the domestic oil producers around the country, particularly in the West and the South.

I think if anything else, if I might add, it has been repeated a couple of times, but let us not just take a snapshot here and forget about it. Let us not just tell the American people that we are doing something when in reality nothing may come out of it. I think what you need and what this country and what the people of this country need is less rhetoric and more action.

I know our colleagues here have also felt the brunt. I know Congressman Sweeney in upstate New York and Congressman Sherwood in Pennsylvania get hit even harder, and you have been vocal advocates in trying to bring about relief and trying to help your constituents and I appreciate your coming here today. You have done a great job as well.

Mr. Chairman, I think what—if I could underscore one more time—that life is a two-way street, and this issue of OPEC's decrease in production, I agree with my good friend from Ohio, that several years ago we lost American lives because we were there for Saudi Arabia and Kuwait and now, all of a sudden, it seems that they forgot those lives that were lost.

Right now there are being in Staten Island, Brooklyn, across the Northeast who are paying a lot for gas at the pump and home heating oil. If anything comes out of this, and I am as big a believer in the free market as anybody here, but technically we do not have one because as long as we are dependent on places like Saudi Arabia, Kuwait and Mexico and Venezuela for our oil, we do not live in a free market. If anything comes out of this, I would hope it is a united Congress and an Administration that sends a signal around the globe that when the chips are down for us we expect help, just as we are there for them when they need help. With that, I yield back the balance of my time, Mr. Chairman.

Mr. BARTON. Thank you, Congressman, and I want to commend you on the effort that you put in on this issue. You were one of the first Congressmen to ask me to conduct this type of a hearing and you have been very aggressive in seeing to the needs of your constituents and you are to be commended on that.

Our last opening statement is going to be from the gentlelady from New Mexico, Congresswoman Heather Wilson, who has helped this subcommittee in obtaining a witness for later in today's hearing. Congresswoman Wilson.

Mrs. WILSON. Thank you, Mr. Chairman, and I wanted to thank you for holding this hearing.

I have a slightly different situation than the folks in the Northeast in that New Mexico doesn't rely as much on home heating oil, but on Sunday the price of a gallon of gas at the Chevron station at I-25 in Lomas was $1.49.9 and it is probably 2 or 3 cents higher than that by today. The New Mexico Hotel and Motel Association says that they have historic low advance bookings for June, July and August and the No. 1 reason they believe—that we have got a great economy otherwise—but people are not planning to drive this summer and it is going to affect tourism across America.

Eighteen months ago, or for the 18-month period between 1997 and mid-'99, we had historic low prices for oil that cost $3.7 billion to the New Mexico economy, 1500 jobs and $25 billion to the Nation as a whole. Where was this Administration on energy policy then? Frankly, it is pretty much where we are now. I don't think they have a policy and we are all suffering the fluctuations because of it.

The reality is that the problem is the fluctuations and it is the dependence on foreign oil that is driving many of those fluctuations. It is not a free market. It is a cartel. You are exactly right—and those countries will do what it is in their national interest to do.

In 1998 52 percent of the oil consumed in the United States was from foreign sources. That is the highest level in history, the highest percentage in history, and at the same time we have a tax structure and a regulatory structure that cuts off responsible exploration, that encourages foreign exploration, and that limits offshore drilling. We have taxes on gasoline, and most folks don't know that of that $1.49 they paid last weekend at the pump per gallon 18.3 cents is in Federal taxes. It used to be 14 cents before the tax hike of 1993. The same with diesel—24.3 cents is taxes.

I think the question today that I am going to have for some of the folks particularly from the Department of Energy is what is the plan? For 12 months—it was 12 months ago that OPEC said we are going to cut production and started to hold together. As long as a cartel holds together America has a problem. They were inactive for 12 months and then we see a flurry of airplanes going around the world asking people on bended knee with hat in hand to increase production. That is not a policy. That is a plea, and we need to come up with a policy.

I am glad they released the LIHEAP funds for folks in the Northeast and I hope that that helped some, and likewise looking at weatherization assistance, but that doesn't solve the problem. These are little band-aids and we need to get a serious policy to reduce reliance on foreign production.

Thank you, Mr. Chairman.

Mr. BARTON. Thank you to the gentlelady from New Mexico. We are now going to welcome our first panel. All other members are not present who have yet to make an opening statement who wish to make an opening statement, the Chair would ask unanimous consent that their statement be included in the record at the appropriate point.

Is there objection? Hearing none, so ordered.

[Additional statements submitted for the record follow:]

PREPARED STATEMENT OF HON. CLIFF STEARNS, A REPRESENTATIVE IN CONGRESS FROM THE STATE OF FLORIDA

Thank you Mr. Chairman for holding this hearing.

One dollar and eighty cents. That's what average Americans can expect to pay for a gallon of gasoline this summer. Home heating oil will cost even more. So, I need not emphasize the importance for this Subcommittee to examine the recent spike in oil prices and how this Administration deals with such changes in the market.

In February of last year, crude oil was $12 per barrel. 12 months later—the cost rose to over $30 per barrel. Though these prices, when adjusted for inflation, are below historical oil prices, there is cause for concern.

Some have called for the President to drawdown the Strategic Petroleum Reserve. At this time, I would caution against such action. This reserve was created to sustain the US in the event of a major disruption in its energy supply.

However, we must examine all aspects of this issue including allegations of "price gouging" by oil companies and most importantly our dependence on foreign oil. Our dependence on foreign oil has increased since the oil crisis in the 70's. Over 50% of our oil is imported leaving our economy at the whim of a handful of nations. This is a national security concern. And one not to be taken lightly.

Regardless of where each of us stands on addressing the oil price issue, I am most concerned with the Administration's handling of this recent price spike.

In March of 1999, OPEC met and agreed to reduce oil production. That was nearly a year ago. The federal government had more than enough time to prepare for what inevitably would result from a decrease in supply—an increase in price.

In fact, the Department of Energy did not announce any major action until just last month per its news release dated February 10. Even more amazing is that Secretary Richardson in a Boston meeting was quoted as saying "the federal government was caught napping."

Heaven forbid if any of our military leaders were to use such an explanation.

And speaking of unprepared, for the record Mr. Chairman, I would like to note that DOE did not get its testimony to the subcommittee until 8:30 last night. However, I guess we should be used to this by now.

I do question some of the actions proposed or taken by the Administration. For instance, the President released nearly $300 million in Low-Income Home Energy Assistance Funding in response to the home heating oil crisis.

While, this undoubtedly provided needed relief, I wonder if the Administration considered that much of the emergency LIHEAP funding will also be needed for air conditioning in the summer. We can expect another summer of extreme heat and many Americans will need such assistance.

In addition, waiving "hours of service" regulations for commercial trucking and deferring routine maintenance at refineries may cause more additional problems.

Mr. Chairman, we have a lot to learn today, and I look forward to the testimony of our distinguished Member panel, as well as the Administration and Industry witnesses. Thank you.

PREPARED STATEMENT OF HON. TOM BLILEY, CHAIRMAN, COMMITTEE ON COMMERCE

Mr. Chairman, before I give my statement I would like to welcome Congressman Boucher from my home State of Virginia as the new ranking member on this Subcommittee. I think the gentleman will make an excellent ranking member and I am happy to see we have finally broken the lock the State of Texas has had on this Subcommittee.

Thank you, Mr. Chairman. I'd like to commend you for holding this hearing on oil prices and I welcome the Members that have come to testify before the Subcommittee today.

As everyone is well aware, recently there has been a dramatic increase in the price of crude oil and oil products, including home heating oil, gasoline, and diesel fuel. Although heating oil prices have declined as the temperature has risen, I am told gasoline prices for this summer will reach heights we haven't seen for years. Like many members, I am concerned about the impact these high oil prices are currently having on consumers and on our economy.

There are always events out of our control that impact the price we pay for oil: the decision of OPEC to decrease production; a sudden, an unexpected cold snap; an increase in the demand for oil in Asia; and the unexpected shutdown of refineries. Given all that, this hearing will look at whether government intervention is necessary or appropriate on this matter.

This hearing will provide an opportunity to explore this country's policy on oil markets and our energy security. We need to assure that the U.S., not officials in countries thousands of miles away, is in charge of its energy policy.

I welcome today's witnesses, and I am especially looking forward to hearing the testimony of our colleagues. Thank you.

PREPARED STATEMENT OF HON. RON KLINK, A REPRESENTATIVE IN CONGRESS FROM THE STATE OF PENNSYLVANIA

I want to thank Chairman Barton and Ranking Member Boucher for holding this hearing today to talk about high fuel prices and what we can do to bring relief. I want to welcome all of our witnesses today, especially Mr. Sam Farruggio, who is from Bristol, Pennsylvania, and who runs a trucking business of over 100 trucks in the northeast. Mr. Chairman, I will also submit for the record a statement from Mr. Jim Luchini of Kirk Trucking in Delmont, Pennsylvania, who sent me figures, back in January, showing that prices at the diesel fuel pumps increased in some places by 10 cents in 24 hours. Also, on January 26th, the *Pittsburgh Post Gazette* reported that diesel prices shot up about 40 cents in the previous week.

We need to get the price of crude oil down to normal levels so our folks can afford to live. The problem began in March of last year, when OPEC decided to cut oil production by 7.5% because they wanted bigger profits. As a result, home heating oil prices skyrocketed, and diesel fuel prices haven't been under $1.00 a gallon since. Diesel fuel prices in Pennsylvania were up to $1.96 a gallon at the beginning of February and, as of March 6th, are now $1.60 a gallon.

I am here today to tell you that I understand and appreciate what a dramatic impact these increases are having on truckers and their families, and on people trying to pay their home heating bills.

Here is a case study. In February, when the Independent Truckers drove their trucks in to Washington to protest skyrocketing diesel prices, the *Washington Post* wrote a story about the Ericksons from Meyerstown, PA who own their own rig. Mrs. Erickson is now helping her husband to drive the truck, to make ends meet and to cover operating costs, and they had to pull their 14-year-old daughter out of school and are now home-schooling her in the cab of their truck. No family should have to disrupt their lives so drastically, because of high prices at the gas pumps.

Congress, and the Administration, have discussed every option imaginable. Congress has met with President Clinton, and Energy Secretary Richardson has been all over the Mideast urging OPEC countries to increase production. After our citizens fought the Persian Gulf War, risked their lives, and some lost their lives, to keep our allies free (Kuwait) the least they can do for us is to increase oil production. After meeting with Secretary Richardson, OPEC nations have agreed to meet on March 27th to decide whether they will increase production.

This week, I have introduced a resolution in the House saying that, if OPEC leaders fail us, and don't increase production, the President should draw down the Strategic Petroleum Reserve (SPR) to give us relief The SPR contains 586 million barrels of oil, and if OPEC fails us, then we must tap in to our own reserves. I would appreciate the support of my colleagues on the Committee for this resolution.

I am also a co-sponsor of a bill, introduced by Congressman Sanders of Vermont, to create a special 6 million barrel oil reserve for the northeastern states. This will help diesel truck drivers, farmers, who must operate tractors, drivers of regular cars, and persons paying home heating oil bills. Here is how it will help: if we have an emergency or severe winter weather, the 2 million barrels of oil will be used for home heating oil purposes. If the severe winter continues, then we will draw on an additional 4.7 million barrels of oil kept in reserve to heat homes. That way, diesel fuel will not be confiscated to use as home heating oil, because the reserves were there. This will keep prices down for truckers, car drivers, and farmers driving tractors.

In addition, as quickly as possible, Congress needs to pass the Supplemental Appropriations bill in which the President asked for an additional $600 million for LIHEAP funds, $19 million for the Home Weatherization Program run by the Department of Energy and another $1 million for the Small Business Administration to provide low-interest loans for small businesses to get through the crisis.

If more Pennsylvanians can weatherize their homes, their heating bills will go down. The extra funds for LIHEAP will give SBA a total of $86 million to give loans to home heating oil dealers so they can extend flexible payment terms to their customers. Loans will also be available to loggers and truckers who were affected by the price spikes.

I look forward to working with my colleagues in Congress and the Administration to determine whether we need to re-examine our policy regarding the Strategic Petroleum Reserve and United States energy policy in general.

Again, I want to thank our witnesses, especially Mr. Farruggio who came from Pennsylvania and gave us the message we all must remember—"we have seen the fuel prices move as much as 15 cents a in one day and changes at the pump two to three times in one day." We must resolve this, so working men and women of America can afford to live and work without passing costs on to consumers due to high oil prices. Thank You, Mr. Chairman.

Mr. BARTON. Due to a pending engagement, we are going to recognize the gentleman from New York, the Honorable John Sweeney. We will go with you first, then we will start with Mr. Moran, Mr. Sherwood, and hopefully by that time Congressman Crowley of Pennsylvania will be joining us, so Mr. Sweeney, your statement is in the record in its entirety and we recognize you for 5 minute to summarize and appreciate your appearance before the committee.

STATEMENTS OF HON. JOHN E. SWEENEY, A REPRESENTATIVE IN CONGRESS FROM THE STATE OF NEW YORK; HON. JERRY MORAN, A REPRESENTATIVE IN CONGRESS FROM THE STATE OF KANSAS; HON. DON SHERWOOD, A REPRESENTATIVE IN CONGRESS FROM THE STATE OF PENNSYLVANIA; AND HON. JOSEPH CROWLEY, A REPRESENTATIVE IN CONGRESS FROM THE STATE OF NEW YORK

Mr. SWEENEY. Thank you, Mr. Chairman. I want to thank you and the ranking member, Mr. Boucher, for conducting this hearing. I am extremely thankful. As you know, I have had a number of conversations with you in the halls of Congress about this particular issue.

And while we may not agree on all or share the same views on all of the issues attendant here, I think we do agree on the need to begin to develop the process for finding a long-term solution based on self-reliance.

This hearing is an important event for those of us in the Northeast, because, frankly, the Administration has viewed this with benign neglect. They have ignored our pleas and they have shown no leadership.

They have detached; they don't feel our pain. And I think if I can do something important here, it will be to put a human face on what's happening in my region of the United States in upstate New York.

Many of my constituents have been shocked at what has happened with fuel and oil prices as they have risen, but I'd like to start by saying that as New Yorkers, we prepare and plan for all sorts of weather conditions in the Winter, and we have a lot of experience.

Whether it's families putting plastic over their windows for extra insulation, or pulling sweaters out for warmth, or adjusting the thermostat down to preserve fuel, New Yorkers, we know how to prepare for cold winters.

But this is one that we were really caught by surprise on, and I think it will give you a real sense of the kind of issues that exist out there, as you begin the journey to find solutions.

In January, one constituent called and told me that he was using his overtime wages to pay the heating bill, rather than saving for his children's education.

A senior citizen called and explained that she didn't act quickly enough to stop the oil distributor from delivering the recap on her oil tank, and filling her oil tank, as is usually done in my neck of the woods, was faced with a $450 oil bill.

This woman is collecting a Social Security check each month for just under $400, and this current situation is real to her. It leaves her finances decimated.

These are just two of the many examples of this horrendous situation, and how people are dealing with this extreme hardship. With the high cost of home heating fuel ruining many family budgets, people have had to cut expenses elsewhere.

Often, too many people are literally having to choose between putting food on the table for their families and having a warm home.

The crisis has been so severe that an oil distributor in my District recently told me that he was hoping for warmer weather quickly. That's like hearing that Frosty the Snowman wants to sing about how he is looking forward to Spring.

This gentleman told me that they were only delivering in quantities of 100 gallons, because most folks could not afford more, and he could not get enough fuel from producers to satisfy the demand, because there was not enough heating oil in the region.

For further reference, he usually will not deliver less than 150 gallons, because he can't justify the cost.

Truckers, as many of your committee have pointed out, are feeling the pinch in high diesel prices. Mr. Bryant mentioned the rally that was held earlier this month in Washington.

I live in an area where mass transit is not readily available. The trucking industry is a major, major component of our economy, and the area is very dependent on moving goods and supplies by using truckers.

Many truckers in my District are finding it too expensive to start their engines, and are simply quitting the business. An industry that already has a shortage of drivers doesn't need this additional burden.

The stories continue: Whether it's the small manufacturing plant pouring its profits into fuel tanks, the grocers who must pay more for food to be shipped, the local government that finds its heating bills doubled, forcing them to cut back on services; this crisis has affected everyone in the region.

In response to this emergency situation, I have sent, as have other Members of Congress, sent letters to the President and to the Secretary of Energy, asking them to release emergency LIHEAP dollars and to consider opening the Strategic Petroleum Reserves to get more oil into the region.

Many of our colleagues have joined us, as I said, in this call, asking that we reduce the burden in the Northeast, in particular, but with all due respect to those who feel otherwise about the Administration's response to this, it has been grossly inadequate.

They have been, as I said earlier, treating this with benign neglect. The entire State of the New York, in the first release of funds, received $2.6 million in emergency assistance, while our friends in Maine and in surrounding States received five times that emergency aid.

We quickly called for assistance to help New Yorkers, but were rebuffed by the Administration, which still refused to acknowledge there was an emergency situation in the first instance.

Only after LIHEAP funds became an issue in the current New York Senatorial race, did the White House release more funds. Too little, too late, is what we heard from most of the constituents and most of the people in upstate New York.

The White House had an opportunity to release from the SPR in January, yet they have steadfastly denied there was any problem in the first instance. Now, after belatedly acknowledging that there is not enough oil in the market, the Secretary of Energy has traveled the world with hat in hand, asking OPEC to increase oil production to help get us out of this situation.

In 1984, President Reagan announced that the SPR would be drawn down in early in disruption such as what the Northeast is experiencing now. If this Administration had acted when they were first asked to, and acted in accordance with President Reagan's policy regarding the SPR, this crisis may have been shortened.

By strategically releasing oil from the reserves into the Northeast in January when there was a definite disruption in the oil supply, oil would have made it through the process to the consumer at a much cheaper price by mid-February.

I see that my time has expired, Mr. Chairman. I want to say that I have a couple of bills in committee that I'd like you to consider:

One that would require the Department of Energy to study and report back to you, the causes, and to make definitive, tangible recommendations; and the second is to create a Northeastern Reserve so that we in the Northeast may find an ability to be independent in and of ourselves.

But I can't overstate how critical this issue is in my neck of the woods, how people are really suffering from this issue. I thank you very, very much, for conducting this hearing, and hopefully beginning a real discussion and national debate on how we make sure that this never happens again.

[The prepared statement of Hon. John E. Sweeney follows:]

PREPARED STATEMENT OF HON. JOHN E. SWEENEY, A REPRESENTATIVE IN CONGRESS FROM THE STATE OF NEW YORK

Good morning Chairman Barton and Ranking Member Hall. Thank you for allowing me the opportunity to testify before the committee. I congratulate you for holding a hearing on this important topic and am pleased to be able to help shed some light on this terrible situation. My comments will be directed at the recent home heating fuel price surge in the Northeast and its effect on my constituents.

As you know, the recent heating fuel price spike sent home heating oil, kerosene, and diesel prices through the roof. Many of my constituents were shocked when home heating oil prices rose from just over a dollar per gallon last fall to more than two dollars per gallon. No one can accuse New Yorkers of not expecting temperatures to drop during the winter months—everyone knows and prepares one way or another. Whether families are putting plastic over their windows for extra insulation, pulling out sweaters for warmth, or waxing their skis in preparation for the coming snow, residents of New York know cold weather.

However, the sudden cold snap, which kept the region in icebox temperatures for weeks, sent heating fuel prices skyrocketing. In January, one gentleman called and told me his story—how he is using his overtime wages to pay the heating bill rather than saving for his child's education. A senior citizen called and explained that she was not quick enough to stop the oil distributor from filling her heating oil tank like ususal, and was faced with a $450+ oil bill. Her Social Security check for the month was for just over $400—leaving her finances decimated. These are just two of the many people who contacted me about this horrendous situation. With the high cost of home heating fuel ruining many family budgets, people have to cut expense elsewhere. Too many people are having to choose between food on the table and a warm home.

Another perspective of the problem came from an oil distributor in my district who told me he was hoping for warmer weather. That's like hearing Frosty the Snowman sing about how he's looking forward to Spring! This gentleman told me they were only delivering in quantities of 100 gallons—because most folks could not afford more and he could not get enough fuel from producers to satisfy demand because there was not enough heating oil in the region. For reference, he usually will not deliver less that 150 gallons—because he cannot justify the cost.

Truckers are feeling the pinch of high diesel prices too. To drive their point home, they staged a mass protest of high diesel fuel prices by driving in convoy down to the heart of Washington. Many truckers in my district are finding it too expensive to start their engines and are quitting the business. An industry that already has a shortage of drivers does not need this additional burden.

The stories continue. Whether it is the small manufacturing plant pouring its profits into fuel tanks, the grocers who must pay more for food to be shipped, the local government that finds its heating bills doubled forcing them to cut back on services, this crisis affects everyone in the region.

In response to this emergency situation, I sent letters to the President and Secretary of Energy asking them to release emergency LIHEAP (Low Income Heating Energy Assistance Program) funds and to consider opening the Strategic Petroleum Reserve to get more oil into the region. While many of my colleagues joined me in saying there was an emergency situation in the Northeast, the Administration was hesitant to act.

The Administration's initial response, in my view, was inadequate at best. The whole state of New York received a whopping $2.6 million in emergency assistance, while our friends in Maine received five times as much emergency aid. I quickly called for more assistance to help New Yorkers but was rebuffed by the Administration, which to my dismay, still refused to acknowledge there was an emergency situation. Only after the LIHEAP funds became an issue in the New York Senatorial race did the White House release more emergency LIHEAP funds.

"Too little too late" is what I heard from many people. The White House had the opportunity to release oil from the SPR in January, yet they steadfastly denied there was a problem. Now, after belatedly acknowledging there is not enough oil in the market, the Secretary of Energy has traveled the world—hat in hand—asking OPEC to increase oil production to help get us out of this situation.

In 1984, President Reagan revised its earlier position by announcing that the SPR would be drawn down early in a disruption—such as the Northeast experienced. If the Administration acted when I asked them to, and in accordance with President Reagan's policy regarding the SPR, this crisis may have been shortened. By strategically releasing oil from the reserves into the Northeast in January, when there was a definite disruption in the oil supply, oil would have made it through the process to the consumer at a much cheaper price by mid-February.

Regardless of Administration actions, all the LIHEAP money in the world wasn't going to help folks who didn't qualify. Even people who did qualify for LIHEAP funds were going forced to wait for their checks, because bureaucracy cannot work that fast.

To prevent this appalling situation from happening again I introduced the Home Heating Fuel Price Spike Act (H.R.3641). My legislation takes two simple steps in this effort. First, H.R. 3641 requires the Department of Energy to fully examine the oil crisis and report back to Congress exactly what happened so we can effectively work together to prevent future problems. The Study also requires the Secretary of Energy to propose alternatives to alleviate future home heating fuel shortages and make recommendations with respect to the suitability and feasibility of each alternative.

Some factors that caused the shortage of heating oil in the Northeast region are:

- Sudden cold snap.
- Poor judgements of how much supply to keep on hand—because the last three winters were warmer than usual.
- Weather related delivery problems—ice on the river, etc.
- Interaction with the natural gas supply.
- Volatile commodity market.
- OPEC policies.

The question is—*how do these factors interrelate.* My legislation will help us get the answers we need.

H.R. 3641 creates a 10 million barrel heating oil reserve in the Northeast region that can be tapped in times of trouble. The reason for creating a reserve in the region, rather than capitalizing on the existing SPR, is the amount of time it takes to get oil from the SPR to the Northeast. There is a definite possibility that in the future, a severe cold spell will shut down river traffic for an extended period of time, leaving thousands of residents without access to heating oil. In an emergency like this, it will take too long to find enough trucks to haul a million barrels of oil, then load up the trucks and drive them halfway across the country. The only reasonable solution to this problem is to establish a heating oil reserve in the region.

Whether we establish one, two or three different sites across the Northeast—in times of emergency, oil distributors would not have to wait for oil to be trucked across the country. Since the problem is getting heating fuel into the region, having a reserve located there solves half the problem.

H.R. 3641 will help us get the facts on what thrust us into this situation, so that we can work together to prevent such an emergency from happening again. Creating a heating oil reserve in the region to guard against future shortages is a good and necessary first step.

We have lived through a terrible crisis that never had to happen. Too many families have had their savings depleted and budgets racked. Too many have had to choose between food on the table or a warm home. I am grateful that nobody has died because of this needless tragedy. By considering H.R. 3641, we will get the answers we need. I look forward to working with you on this extremely important issue.

Thank you again for allowing me the opportunity to testify before the committee. This concludes my testimony.

Mr. BARTON. Thank you, Congressman. I can assure you that this is not the only hearing we're going to have this Spring or Summer on this issue. This is not an ending; this is a beginning.

I now recognize the gentleman from the great State of Kansas. Again, your statement is in the record in its entirety, and we would recognize you for 5 minutes to summarize, Mr. Moran.

STATEMENT OF HON. JERRY MORAN

Mr. MORAN. Mr. Chairman and Mr. Boucher, thank you for the opportunity to appear once again before this subcommittee.

Three years ago this month, I made my first speech on the House floor, highlighting the importance of domestic oil production, and our dangerous reliance upon imported oil, and calling for the development of a national policy on our dependence.

At that time, oil prices were sliding, were under $15 a barrel; gasoline was around 80 cents a gallon. Within the next 12 months, the price of crude would reach $7.75 per barrel for Western Kansas Crude, and would remain under $10 a barrel for most of the next year.

As a result of this dramatic price decline, more than 136,000 wells were shut down, and more than 41,000 jobs were lost in the oil and gas industry.

This amounts to 136,000 wells and 41,000 people not today producing oil to meet the country's energy needs.

It was during that time that I introduced legislation aimed at reducing the cost of production for independent oil and gas producers. The bill I introduced seeks to boost domestic production by lowering the tax burden on independent producers, increasing the credits for advanced oil recovery, and calling for a strategic plan, including additional research and development to address our national security needs when oil imports reach 60 percent.

While the focus of today's subcommittee hearing is on the cost of energy paid by the American consumer, the solution for today's consumer is the same as the solution for the independent oil producer. We must encourage production in our domestic industry, and limit our dependence upon foreign supplies of petroleum.

High oil prices are a burden that we all bear. Kansas is a transportation-dependent State with long distances between our communities and many commodities to haul, and we normally have an extremely cold Winter.

Whether it's the Kansas farmer preparing now his fields for Spring planting, the trucker hauling wheat to the elevator, or the Kansas City commuter on her way to work, we all pay when our dependence on foreign oil becomes too great.

While we may be upset about the current situation, we certainly can't say it comes as a surprise. In the last 7 years, U.S. oil production has fallen by nearly 20 percent, while oil consumption continues to increase.

During the 25 years since the last oil crisis when we lined up at the pumps, our reliance on foreign oil has increased from 37 percent to nearly 57 percent today. Today's higher crude prices alone are insufficient to increase domestic production, particularly in the short run.

Kansas producers who have lost much of their equity in the years of 1997, 1998, and 1999, find it very difficult to convince lenders to take a risk in exploring and developing new leases now in the year 2000.

When prices are dependent upon the actions of OPEC rather than on free market forces, the ability to take risks necessary to find and produce new sources of oil and gas are limited.

Does the Kansas small, independent producer invest necessary money today, not knowing what the world price will be tomorrow? In Kansas, the average daily production is 2.2 barrels per day.

The cost per barrel is very high, and the price received for that barrel determined by foreign suppliers. The stability which comes from greater control of our own destiny through increased domestic production is what is required.

Today's situation is a clear signal for Congressional action. It's our obligation to develop tax policies, regulatory policies, and research funding that will allow us to raise domestic production to meet the demands of the U.S. economy.

Mr. Chairman, I do not come here today to indicate that the legislation that I introduced last year is the be-all and end-all or the solution to the current situation. There are many other options that you will hear about, and they should be considered.

However, I do come here today to say that our strategy for dealing with our energy needs must be something more than simply begging at OPEC's door. Thank you.

Mr. BARTON. Thank you, Congressman. We appreciate your leadership on that legislation, and it will be at the top of legislation that this subcommittee will be looking at. I can't guarantee you that we're going to come down exactly where you are, but it's certainly a good place to start looking.

Mr. MORAN. Thank you, Mr. Chairman.

Mr. BARTON. We'd now want to recognize a very patient Congressman from the great State of Pennsylvania, Mr. Sherwood, who has been a strong advocate for action in this area. He also has been very aggressive in working with me to try to help us put this hearing together.

Your statement is in the record in its entirety, Congressman, and we'll recognize you for 5 minutes to summarize.

STATEMENT OF HON. DON SHERWOOD

Mr. SHERWOOD. Thank you very much, Mr. Chairman. I appreciate your consideration, and I think this is a very important issue today.

And if you'll look at the Northeast, it will give you a road map of where we might be going in our current oil crisis. This Winter in the Northeast, we had an extreme shortage and an extreme price spike.

Diesel fuel went from $1.30 to $2.60. Home heating oil went from 90 cents to $1.80, so we had elderly people trying to decide whether to buy food or buy fuel. You've heard all those stories.

The people who are making out great in the Northeast are the people who repossess trucks. Their lots are full. All the repossession guys are going out to pick up the trucks of the independent truckers who have had their costs go up so strongly, so quickly, that it has disrupted their lives and ruined their livelihoods.

And I know that you folks from the oil patch have seen that in the past. When the price of oil gets ridiculously low, there is crisis in the oil patch.

When it gets short or ridiculously high, there is crisis in the Northeast and across the rest of the country.

And, you know, we talked very strongly to Secretary Richardson this Winter that we needed some action. We didn't get it.

When the Northeast got short on oil, then the speculators took over on the New York Merc, and there were fortunes made because of the shortage of oil. That fortune didn't go to the independent producers in the oil patch; it went to the people who were able to speculate on the New York Merc.

So, I'd like to think of the Strategic Petroleum Reserve as flood control dam. And I think that when your prices are low, we ought to buy in that Reserve very heavily; when there is a shortage or there is not enough oil and the prices are very high in the rest of the country, that's a good time to let a little of the flood control waters out of that dam.

We have to have an energy policy, and it doesn't seem to me that we have an energy policy. We need to find both short-term and long-term solutions by which the United States can reduce its dependence on foreign oil.

As a member of the Armed Services Committee, I'm particularly concerned about our reliance on foreign oil which may be cutoff during times of crisis. After the fall of the Warsaw Pact forces, we have dramatically reduced the size of our Armed Forces.

If we're confronted with responding to a multi-front crisis, we would have the ability to prevail only on our national security objectives if they diverged from those of OPEC nations. If our oil supply is at any time shut off, we're in very grave danger.

I think that if we could develop a policy where if oil is cheap and the oil patch is in crisis, that's a great time for the Strategic Oil Reserve to buy. If we're short, that's a good time to use that as a lever.

If we had released the Strategic Petroleum Reserve in January as President Bush did 10 years ago, it would have discouraged the speculators on the New York Merc, and it would have saved a great deal of pain and suffering, ruination of lives, crisis situations, and failed businesses in the Northeast.

Mr. Chairman, thank you for giving me the opportunity to testify on this most important matter. The time for action is now.

We need to create an effective national policy which is prudent, responsive to demand, and sound. Thank you for your consideration.

Mr. BARTON. We want to thank you, Congressman Sherwood, for your attention to this matter. Your expertise is going to be of benefit to the subcommittee as we continue on these hearings, and then decide what legislative action, if any, to take.

We are not going to ask the Congressional panel questions. We can meet with you individually and collectively, if necessary. Our other panel members, we don't have that option, so we're going to excuse you.

The Chair will announce that if Congressman Crowley does show up, we'll put him on the panel that's currently before the subcommittee. But this panel is excused.

We'd now like to call forward our panel from the executive branch. We should have in the audience, Mr. Mark Mazur, who is the Director of the Office of Policy for the United States Department of Energy; we should also have Dr. John Cook, who is the Director of the Petroleum Division of the Energy Information Administration; and we should have Mr. Richard G. Parker, Director of the Bureau of Competition for the United States Federal Trade Commission.

Mr. BARTON. Gentlemen, welcome to the subcommittee. Your testimony is in the record in its entirety, although two of you were somewhat tardy in getting it to the subcommittee; but, that will be addressed at a later time. We're going to start with you, Dr. Cook. We'll put your statement in the record. We're going to recognize you for 7 minutes. Then, we'll go to Mr. Mazur; then, we'll go to Mr. Parker. So, Dr. Cook, welcome to the subcommittee and you're recognized for 7 minutes.

STATEMENTS OF JOHN COOK, DIRECTOR OF PETROLEUM DIVISION, ENERGY INFORMATION ADMINISTRATION; MARK MAZUR, DIRECTOR, OFFICE OF POLICY, DEPARTMENT OF ENERGY; AND RICHARD G. PARKER, DIRECTOR, BUREAU OF COMPETITION, FEDERAL TRADE COMMISSION

Mr. COOK. Thank you, Mr. Chairman. I wish to begin by thanking the committee for the opportunity to testify on behalf of Jay Hakes, the administrator of the Energy Information Administration. Regrettably, he was unable to be here today.

As has become increasingly apparent to consumers, world crude oil and refined product prices have risen rapidly over the last 12 months, from about $12 a barrel in February 1999 for crude oil, to as high as $34 this week. While the change is dramatic, I would be remissed in not noting that in inflation adjusted terms, such prices are still less than the $70 levels seen in 1981.

The recent price rise is, of course, the result of a notable shift in the global balance between demand and crude production. Crude oil markets tightened in 1999, as OPEC and several other key exporting countries significantly reduced supply, while, at the same time, economic recovery in Asia restimulated demand growth. In 1999, global demand out paced production by over a million barrels a day, reducing surplus world inventories by almost 400 million barrels. If OPEC were to restrain production in this year to the levels seen recently, we estimate that the shortfall in 2000 would be as much as 2 million barrels a day.

Further complicating the supply picture, crude oil prices have risen faster than product prices this year, reducing refining margins. This squeeze on margins, on top of already high crude oil prices, encouraged refiners to restrain crude purchases, restrict product output, and draw down crude and product inventory. By the end of last year, world stocks had dropped to very low levels, especially in the U.S.

If I may call your attention to the first chart, on the east coast, distillate stocks began the winter season just past—almost past.

Mr. BARTON. Dr. Cook, is distillate, would we call that fuel oil?

Mr. COOK. Yes, sir, that's—distillate, which is comprised of both heating oil and diesel fuel. And what we're seeing here is that we began the winter in October with more than ample supplies; but, by the end of December, stocks had dropped significantly below normal levels, which, of course, set the stage for the recent spike in heating oil prices.

Low inventories leave little cushion to meet unexpected shifts in supply and demand and increase the risk of price fluctuations. In the northeast, heating oil prices and diesel prices surged in January, when a combination of cold weather and supply problems occurred in that region in the face of low stocks. With little cushion, local supplies were drained and prices spiked. In the 3-week period ending February 7, retail heating oil prices and diesel prices in New England rose 78 and 68 cents, respectively. In contrast, prices for these fuels elsewhere in the country hardly budged.

Fortunately, a flood of distillate imports arrived throughout the month of February, in response to these high prices. That, in combination with warm weather, eased these market pressures and by the end of last month, heating oil and diesel prices had fallen about 60 cents a gallon, offsetting much of the earlier rise.

With the apparent end of winter in sight, I'd like to conclude my testimony by focusing some comments on the gasoline outlook. Tight crude oil markets are now impacting gasoline in much the same manner as earlier heating oil markets were impacted. The same crude-oil-induced squeeze on margins that drove down distillate stocks has now reduced gasoline inventories. With both crude oil and gasoline stocks at levels not seen for decades, gasoline prices are now climbing sharply, averaging $1.50 this week.

Mr. BARTON. When you say that, Dr. Cook, you're saying it is that they're at all time lows; that the stocks, the amount in inventories is at an all time low?

Mr. COOK. Twenty year low.

Mr. BARTON. Twenty year low.

Mr. COOK. Unfortunately, as high as these prices are, gasoline prices are likely to continue rising, given that both the spring transition period and the peak summer demand period are now looking increasingly vulnerable. During March and April, U.S. refineries typically increase crude throughputs by about a million barrels a day. This year, with low stocks and a market short on crude oil, that situation implies a volatile spring.

But even after this transition, we expect volatility to continue this summer. We expect strong demand, uncertain and possibly limited imports to push utilization rates to very high levels. Given precariously low stocks, this combination leaves little room for the unexpected. Unplanned refinery outages, import delays, sudden surges in demand can push prices well above those forecast in EIA's base case, now at $1.56. Potential volatility could add as much as another 25 cents a gallon to the price, pushing actual prices to be seen this summer possibly as high as $1.80. Although such prices are far from record highs in real terms, this rapid rise over such a short period of time will no doubt continue to attract consumer intention.

That concludes my testimony. I'd be happy to answer questions.

[The prepared statement John Cook follows:]

PREPARED STATEMENT OF JOHN COOK, DIRECTOR, PETROLEUM DIVISION, ENERGY INFORMATION ADMINISTRATION

SUMMARY

World crude oil and petroleum product prices have risen rapidly over the past twelve months, from about $12 per barrel in February to touch $34 this week. While $34 adjusted for inflation is still less than the $70 per barrel seen in 1981, the extreme price volatility over the last year has created market dislocations. The recent price rise is the result of a shift in the world balance between production and demand. Over the last year, as OPEC and several other exporting countries cut output, world oil demand exceeded production, and inventories were used to meet demand growth. World inventories of crude oil and products are now at low levels, and continue to fall.

Low inventories leave little cushion to meet sudden increases in demand or decreases in supply, increasing the possibility of price runups. In particular, U.S. Northeast heating oil and diesel prices surged in January 2000, when cold weather and supply problems occurred in the region on top of low stocks. With little distillate stock cushion, local supplies were diminished, and prices spiked. Large volumes of distillate imports, warm weather, and increases in production have since resolved this supply shortage in the Northeast.

We are now facing a very tight gasoline market. U.S. crude oil and gasoline inventories are at alarmingly low levels not seen for decades. On top of low stocks, refineries need to increase crude inputs over 1 million barrels per day during March and April, within a market short on crude oil—creating an environment ripe for gasoline price volatility this spring. But even after we get through the spring, expected high refinery utilization rates on top of precariously low gasoline stocks set the stage for volatility during the summer as well.

INCREASES IN CRUDE OIL, DISTILLATE FUELS AND GASOLINE PRICES

I wish to thank the Committee for the opportunity to testify on behalf of Jay Hakes, Administrator of the Energy Information Administration, who regrets that he was unable to be here. I will focus on the status of the global crude oil market and its effects on the heating oil, diesel fuel, and gasoline markets and prices. As I will illustrate, world demand exceeded crude oil production in 1999, largely as a result of the decline in production by the Organization of Petroleum Exporting Countries (OPEC) and several other exporting countries. Inventories were used to meet the excess demand, and prices rose in response. Today, world inventory levels are very low, leaving markets vulnerable to price spikes, such as that just experienced for heating oil and diesel fuel in the Northeast.

U.S. Dependence on Petroleum

Today, the United States is still heavily dependent on crude oil, in spite of the growth in use of other fuels like natural gas and coal. In 1998, petroleum supplied 39% of our energy needs. Since 1985, domestic crude oil production has been declining while oil product consumption has been increasing, resulting in a growing reliance on imports. In 1974, net imports of crude oil and products supplied about 35 percent of U.S. consumption. In 1998, net imports supplied about 52% of U.S. petroleum consumption, the highest percentage ever. However, this dependence is offset, to some extent, by an ongoing decline in petroleum's role in the economy. Over the last 20 years, spending on petroleum has dropped from about 8 percent of all spending on U.S. goods and services to about 3 percent.

Crude Oil Market and Recent Price Increases

Crude prices have changed significantly over the past year. Prices have risen more than $20 per barrel (48 cents per gallon) from under $12 per barrel in mid February 1999—the lowest prices in nominal terms since 1986—to $34 per barrel recently. To put this in perspective, while this represents the highest price since the Persian Gulf War, crude oil prices peaked in 1981 at $70 per barrel in today's dollars ($39 per barrel in nominal terms). Recent EIA forecasts show that these high prices have resulted in a decline in OPEC's market share of over 1% from fourth quarter 1999. Non-OPEC production in the fourth quarter was higher than expected, indicating higher oil prices may be stimulating more non-OPEC production than many analysts predicted.

Nevertheless, crude oil markets tightened in 1999 as OPEC and several other exporting countries reduced supply, and, at the same time, recovery of Asian economies increased demand growth. In 1999, world oil demand exceeded production by over 1 million barrels per day for the year, reducing world inventories by nearly 400 million barrels. If OPEC were to keep production in the year 2000 at the levels seen in the first quarter, EIA estimates the shortfall in 2000 could be up to 2 million barrels per day. Should such production levels be sustained, the resulting higher prices would have adverse impacts on inflation and economic growth.

During 1999, crude oil prices rose faster than product prices, reducing refining margins. The squeeze on margins, on top of high crude oil prices, encouraged refiners to constrain crude oil purchases, restrict product output, and draw down inventory. By the end of 1999, world crude oil and product stocks sank to very low levels, and U.S. inventories were no exception. For example, as shown in Figure 1, East Coast distillate inventories, which were ample at the start of the winter season, fell well below normal levels by year end, setting the stage for the heating oil price spike experienced in recent weeks.

Heating Oil Price Spike

Retail heating oil and diesel fuel prices (distillate prices) climbed steadily from early 1999 through the middle of January 2000, largely as a result of increases in crude oil prices. But distillate prices in the Northeast[1] turned sharply upward in the third week of January. In a three-week period, New England residential heating oil prices, as shown in Figure 2, rose 78 cents (66 percent) to $1.96 per gallon. During the same three-week period, New England retail diesel fuel prices (Figure 3) rose 68 cents per gallon (47 percent), to peak at $2.12 per gallon. While Northeast prices surged further at the end of January, heating oil and distillate product prices in other parts of the country rose relatively little.

Fortunately, prices peaked in early February, and are now dropping. By February 28, New England residential heating oil prices had fallen 60 cents and retail diesel fuel 48 cents per gallon from their peaks.

Retail heating oil and diesel fuel prices follow the spot distillate markets, which had been driven by crude oil prices until recently. Figure 4 shows that spot crude oil prices for West Texas Intermediate (WTI) changed relatively little, even as No. 2 heating oil spot prices in the Northeast spiked dramatically. New York Harbor spot heating oil prices rose from about 76 cents per gallon on January 14 to peak at $1.77 February 4 before falling back. Gulf Coast prices did not spike, but were probably pulled slightly higher as the New York Harbor market began to draw on product from other areas, again indicating the Northeast focus of this problem.

The late-January heating oil and diesel fuel price surges in the Northeast resulted from a unique combination of low inventories, weather, and supply problems. Low stocks leave little cushion to absorb sudden changes in supply or demand. Distillate stocks fell rapidly in late November through December as high crude oil prices and margin pressure discouraged production. By the beginning of January, East Coast inventories were running almost 4 million barrels, or 8 percent, below the low end of the normal range.

During the last half of January, cold weather in the Northeast not only increased demand, but also caused supply problems, with frozen rivers and high winds hindering the arrival of new supply. It was reported that utilities were buying distillate both for peaking power and, along with industrial and commercial users, to substitute for interruptible natural gas supplies, further adding to the market pressure.

Thus, with new supply being delayed and little inventory to cover the increased demand, prices spiked. Within weeks, a flood of imports attracted by the higher prices, along with domestic resupply, stopped the inventory decline, and prices dropped substantially. Although stocks remain low, with currently mild weather and only a few weeks of the traditional heating season remaining, a surge like that seen in late January is unlikely.

Upcoming Gasoline Season

I would like to conclude my testimony by focusing on the outlook for gasoline. The tight crude oil market is also affecting the gasoline market. U.S. gasoline prices averaged $1.50 this past Monday, an increase of 23 cents per gallon since the beginning of this year. Today, both U.S. crude oil and gasoline stocks are at alarmingly low levels (Figure 5)—levels not seen for decades. The same squeeze on margins that brought distillate stocks down to low levels also reduced gasoline stocks.

I would like you to focus on two time periods—spring and summer. During March and April, refineries need to increase crude oil inputs by over 1 million barrels per day (Figure 6). With low stocks and a market short on crude oil, the situation is ripe for gasoline price volatility. Spot gasoline prices are already reflecting the tight gasoline supply-demand balance. Last week, spot gasoline prices on the Gulf Coast averaged almost 20 cents per gallon higher than crude oil prices—a spread that is about 2 times the average spread this time of year.

But even after we get through the spring, we may see price volatility this summer as well. EIA expects to see high refinery utilization rates on top of precariously low gasoline stocks. This combination leaves little room for the unexpected. Unplanned refinery outages, import delays or demand increases can create price surges above levels shown in the EIA forecast. EIA is currently projecting regular gasoline prices to peak at $1.56 per gallon this summer. Price volatility can result in a 20-25 cent per gallon price surge such as those seen in California historically, which brings the price to $1.80 for a time. Although these prices are far from record highs in real terms, they have risen rapidly over a short period of time, attracting a great deal of consumer attention.

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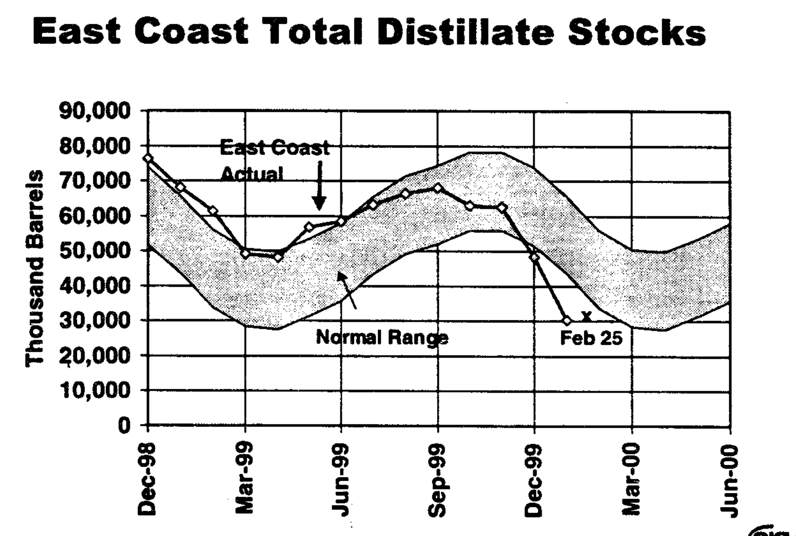
[1] The Northeast includes New England (Connecticut, Maine, Massachusetts, New Hampshire, Rhode Island, Vermont) and the Mid-Atlantic region (Delaware, District of Columbia, Maryland, New Jersey, New York, Pennsylvania).

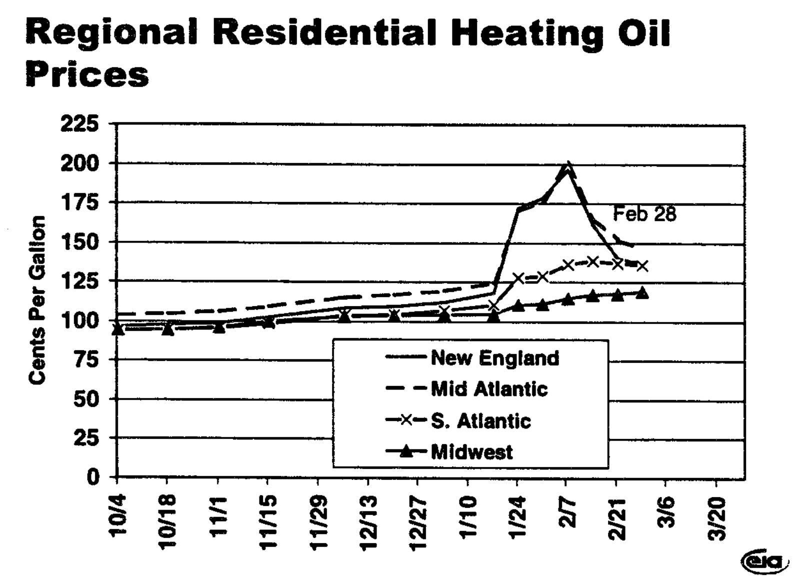
This concludes my testimony. I would be glad to answer any questions that you might have.

Figure 1



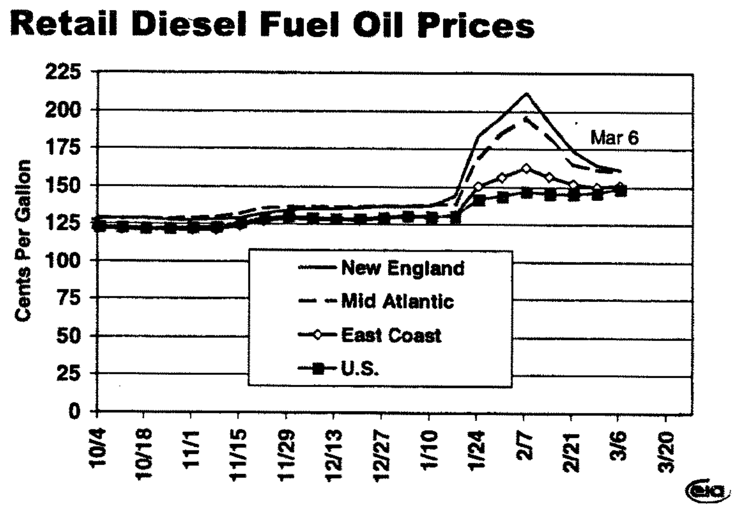
Source: Energy Information Administration

Figure 2



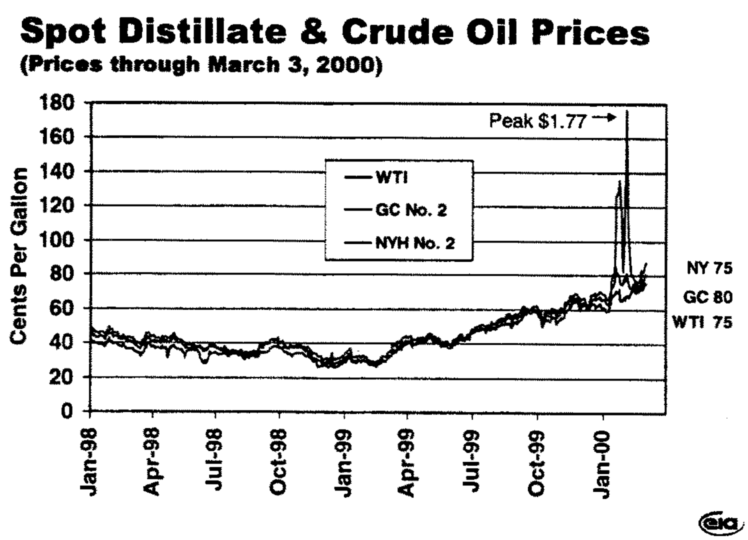
Source: Energy Information Administration/State Energy Office Data

Figure 3



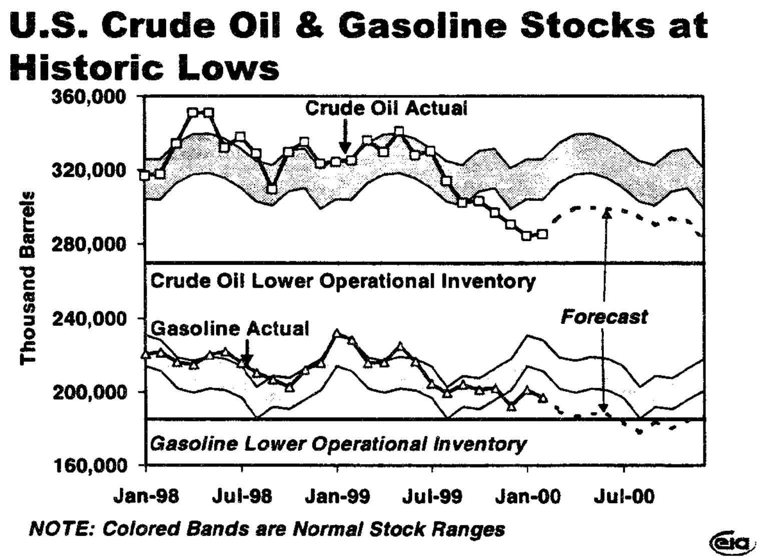
Source: Energy Information Administration

Figure 4



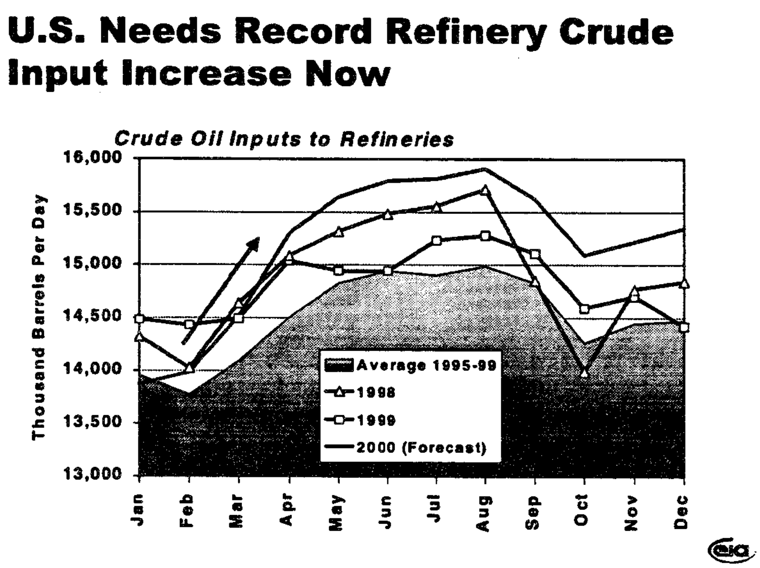
Source: Reuters Daily Spot Prices.
Note: WTI—West Texas Intermediate crude oil price; GC No. 2—Gulf Coast No. 2 heating oil; NYN No. 2—New York Harbor No. 2 heating oil prices.

Figure 5



Source: Energy Information Administration

Figure 6



Source: Energy Information Administration

Mr. BARTON. Thank you, Dr. Cook.

We have Congressman Crowley from Pennsylvania, who has arrived. We have two 15-minute votes pending. We're going to recognize Congressman Crowley for 5 minutes; then, we're going to take a recess to go do the two votes; and we'll reconvene between 12:45 and 1 p.m., to hear our other two Executive Branch witnesses.

Congressman, we welcome you. Your statement is in the record in its entirety and ask you to summarize it in 5 minutes.

STATEMENT OF HON. JOSEPH CROWLEY

Mr. CROWLEY. Thank you. Chairman Barton, and I appreciate your extending the courtesy to allow me to appear before the second panel today.

Mr. BARTON. You've been very patient. And this is an issue that's very important to your constituents and you've been a leader on it and we want to hear what you have to say about it.

Mr. CROWLEY. Thank you, Mr. Chairman. I, also, want to thank Ranking Member Boucher, as well, for his patience, and the other members of the committee.

The massive fluctuations of the price of oil is of extreme concern to my congressional district in New York, in Queens and the Bronx, particularly with respect to the high cost of home heating oil. This winter, an extremely cold one in New York, my constituents and many other citizens of the northeast—including one of the members here on the committee, Vito Fossella, from Staten Island—suffered not only frigid temperatures, but, also, extreme increases in the price of oil.

While oil is used to heat approximately 12 percent of all homes in the United States, in New York State, that number is almost 40 percent. In my congressional district, that number if 46 percent of my constituents, who use oil to heat their home, on over 108,000 households. Many of my constituents have told me that they are paying double for their energy this winter, as opposed to previous years.

I represent a working class district, where most of the home owners are seniors or working families. These are people that are hurting. The skyrocketing costs are hitting these people the hardest. The average income of my district is approximately $30,100 per year. They make too much to qualify for LIHEAP and, at the same time, they make too little to afford an increase of almost $1,000 a year in home heating oil costs.

In my invitation to testify, it was requested that I comment on the likely cause or causes of the massive price swings in the cost of oil. The first and largest cost of the massive price volatility in the market deals with international supply; in this case, the reduction of output by OPEC members and their non-member allies. Since OPEC began their reduction in output in March 1999, the price of a barrel of crude oil rose over $14 a barrel, to over $30 a barrel.

The second reason deals with oil speculators or domestic price gougers, who are using higher prices caused by the decrease in supply to their advantage in gouging the American consumers. Let me point out that this is not a universal stance. There are some oil distributors that I have met with, who are concerned not only about their image, but, also, their customers. They're not looking to have their customers convert to gas heat.

In response to the allegations domestic price gouging have joined, a number of my colleagues in both political parties demand action by our attorney general to investigate the situation. Besides launching a Federal investigation into alleged domestic price gouging, I believe the best short term solution would be to open the strategic petroleum reserve. I understand that you are opposed to that action.

The law creating an authorizing SPR, the Energy Policy Conservation Act allows draw down of the Nation's oil reserves under several conditions, including when a sharp increase of petroleum process would likely have a major adverse impact on the economy of the United States. Economists at the Department of Energy expect the average price of gasoline to hit $1.50 soon. That will be certainly much higher in New York and other major metropolitan areas, where a gallon of gas goes for over $1.80. In fact, other independent economists expect gas prices to hit $2 a gallon, maybe hitting $2.50 a gallon during the peak summer travel season. This is not good for our economy.

I believe the president has the grounds to open the SPRO for these economic reasons, but has continually refused to do so. Therefore, I am supportive of an amendment to the Energy Policy and Conservation Act Reauthorization, H.R. 2884, which recently passed both this subcommittee and the full Committee on Commerce by voice vote—albeit with dissenting views from the minority—to allow for the draw down of the in times of reduction and supply caused by anticompetitive activity.

In the long term, I believe that Congress, working with the oil producing allies, such as Mexico, Norway, Russia, and with OPEC member states, must work together to establish and set stable oil prices. As a member of the committee in international relations, I was pleased that Chairman Gilman and ranking member Gejdenson conducted a hearing on March 1, regarding the issue of OPEC and their price fixing. At the time, I heard the viewpoint of Wes Watkins of Oklahoma, a representative of an oil producing state, who informed the committee on international relations that from a producer's standpoint, the best solution would be to have a stable price for oil. a stable price would rid the people of Oklahoma, Louisiana, and Texas, and other petroleum producing states of the economic insecurities brought on when the prices are too low, just as they would help protect my constituents in Queens and the Bronx and all the people of cold climate States in years like this, when prices skyrocket out of control. This should be a long-term goal to Congress, so we can eliminate these massive price fluctuations.

I, also, believe it's important for us to create a strategic reserve for home heating oil in the northeast, as Mr. Markey mentioned earlier, and I would be supportive of that legislation, as well. And I thank the chairman for this time and yield back the balance of my time.

[The prepared statement of Hon. Joseph Crowley follows:]

PREPARED STATEMENT OF HON. JOSEPH CROWLEY, A REPRESENTATIVE IN CONGRESS FROM THE STATE OF NEW YORK

I. INTRODUCTION

I would like to thank both Chairman Barton and Ranking Member Boucher for holding this important hearing today and for inviting me to speak before the Committee.

II. IMPORTANCE OF ISSUE

The issue of the massive fluctuations in the price of oil is of extreme concern to my Congressional District particularly with respect to the high costs of home heating oil.

This winter, an extremely cold one in New York, my constituents and many other citizens of the Northeast, including the residents of Vito Fossella's Staten Island district, suffered not only frigid temperatures but also extreme increases in the price of oil.

While oil is used to heat approximately 12% of all American homes, in New York State that number rises to almost 40%.

In my Congressional district, 46% of my constituents use oil to heat their homes—over 108,000 households.

My constituents have told me that they are paying double for their energy this winter as opposed to previous years.

I represent a working class district, where most of the homeowners are senior citizens or working families.

These are the people who are hurting—these skyrocketing costs are hitting these people the hardest.

III. REASONS FOR PRICE VOLATILITY

In my invitation to testify, it was requested that I comment on the likely cause or causes of the massive price swings in the cost of oil.

A. OPEC

The first and largest cause of the massive price volatility in the market deals with international supply—in this case the reduction of output by OPEC member states and their non-member allies.

Since OPEC began their reductions in output in March 1999, the price of a barrel of crude oil rise over $14 a barrel to over $30.00 a barrel.

B. Domestic Price Gougers

The second reason deals with oil speculators, who are using the higher prices caused by the decrease in supply to their advantage and gouging the American consumer.

Prices for both home heating oil and diesel fuel are far higher in the Northeast then elsewhere, and in New York City they are higher then in other neighboring Northeastern states.

IV. SHORT TERM SOLUTIONS:

A. Investigation by Department of Justice

In response to the allegations of domestic price gouging, I joined with a number of my colleagues in both political parties to demand action by the Attorney General to investigate this situation.

B. Open the Strategic Petroleum Reserve

Besides the launching of a Federal investigation into alleged price gouging, I believe that the best short-term solution would be to open the Strategic Petroleum Reserve.

The law creating and authorizing the SPR, the Energy Policy and Conservation Act, allows draw down of the nation's oil reserves under several conditions, including when a sharp increase in petroleum process would likely have "a major adverse impact" on the economy of the United States.

Economists at the Department of Energy expect the average price for a gallon of gas to hit $1.50 soon—though it is currently much higher in New York and other major metropolitan areas.

Other independent economists expect gas prices to hit $2 a gallon—maybe hitting $2.50 during the peak summer travel season.

This is not good for our economy.

I believe that the President has the grounds to open the SPR for these economic reasons. But he has continually refused.

Therefore, I am supportive of amending the Energy Policy and Conservation Act Reauthorization (H.R. 2884) which recently passed both this Subcommittee and the full Committee on Commerce by voice vote—albeit with dissenting views from the Minority—to allow for the drawdown of the SPR in times of reduction in supply caused by anti-competitive activity.

President Bush authorized the tapping of the SPR during the Gulf War—and world oil prices dropped by $10 a barrel overnight.

V. LONG-TERM SOLUTIONS:

A. Attain A Stable Price

In the long-term, I believe that the Congress, working with our oil-producing allies such as Mexico, Norway and Russia and with the OPEC Member states must work together to establish a set, stable price for oil.

As a member of the Committee on International Relations, I was pleased that Chairman Gilman and Ranking Member Gejdenson conducted a hearing on March 1 regarding the issue of OPEC and their price fixing. At that time, I heard the viewpoint of Rep. Wes Watkins of Oklahoma, a representative of an oil producing state, who informed the Committee on International Relations that from a producers standpoint the best solution would be to have a stable price for oil.

A stable price would rid the people of Oklahoma, Louisiana and Texas and other petroleum producing states of the economic insecurities brought on when prices are too low just as they would help protect my constituents in Queens and the Bronx, and all of the people of cold climate states in years like this when prices skyrocket out of control.

This should be a long-term goal of the Congress so that we can eliminate these massive price fluctuations.

B. Use Diplomacy to Attain the Objective

I believe that international mutual understanding and cooperation achieved through diplomacy will be our nation's best bet to accomplish the goal of a stable price for oil.

On this score, I believe that Secretary of Energy Bill Richardson deserves the praise of the Congress for his work in communicating the American position on the oil reductions to our OPEC allies over the past few weeks.

Although I believe the Administration could have done and still can do more to help the American people, and diplomacy is no short term answer for my constituents who are suffering, I applaud the Secretary's efforts to meet the long term goals of satisfying both the supply end and demand end of America's oil consumption needs.

I hope that the Secretary's talks will lead to an increase in oil output sufficient to meet world demand in the short term and the establishment of a stable price for oil for the long term.

C. Wean the U.S. off of Imported Oil

I also believe that the United States should look into alternative energy sources to wean our nation off of imported oil.

VI. CONCLUSION

That concludes my remarks, and I again would like to thank the Chairman and the entire Committee for inviting me before you this morning.

I am prepared to answer questions that the Committee my have.

Mr. BARTON. Well, I thank you, Congressman, and I think I mistakenly in my introduction said you were from the great State of Pennsylvania. I want to correct the record and let everybody know you're from the great State of New York——

Mr. CROWLEY. That's quite all right.

Mr. BARTON. [continuing] the Empire State.

I don't want your constituents to think that I'm a dizzy Texan who doesn't know the difference between Pennsylvania and New York, because they're both great States and both well represented in this committee and this Congress.

We're going to recess until approximately 12:45. We have two pending votes on the floor. So, I would surely hope that Dr. Cook and Mr. Mazur and Mr. Parker can be back by 12:45. And that clock is going crazy. I have no idea; but time flies in Congress, but it doesn't fly that rapidly. We're in recess until approximately 12:45.

[Brief recess.]

Mr. BARTON. The subcommittee will come to order. When we recessed, we had heard from Congressman Crowley of New York and we have, also, heard from Dr. Cook. We now would like to hear from Mr. Martin Mazur, who is the director of the Office of Policy at the U.S. Department of Energy. We'll give you 7 minutes to summarize your statement that will be in the record in its entirely. Mr. Mazur?

STATEMENT OF MARK MAZUR

Mr. MAZUR. Thank you, Mr. Chairman. First, I want to start off by apologizing for our testimony being late yesterday. As you know, there's a lot of interest in this hearing and it took a long time for the people within the Department of Energy, within the rest of the administration, to clear off on it. And I understand——

Mr. BARTON. On that—we won't take this out of your time——

Mr. MAZUR. Okay.

Mr. BARTON. [continuing] but Mr. Parker had his testimony here on time and it had to be cleared through all kinds of people. I'm not going to say you, personally, because you haven't testified often, but it seems a chronic problem of DOE, whatever the deadline is, they miss it.

Mr. MAZUR. Okay.

Mr. BARTON. And I am going to talk to Secretary Richardson, the earliest possible convenience and when I do, you know, politely, but firmly say the next time DOE doesn't get its testimony in on time, they won't be a part of the hearing. Now, he may say is that a promise, I don't know; but it's not fair to our members on both sides of the aisle, even when we think we know what you're going to tell us, to not have it so we can verify what you're going to tell us. So, anyway, we set the clock at 7 minutes and we do welcome you to the hearing today.

Mr. MAZUR. Thank you, Mr. Chairman. I want to thank you for inviting the Department here today to testify in recent movements in crude oil and petroleum product prices. One point that I do want to make clear is that the United States does have a longstanding energy policy followed for about 20 years by both Democrat and Republican administrations. This energy policy is grounded in general reliance on markets and prices to allocate energy resources. Usually, these energy markets work well. However, when there are market imperfections or unwelcome distributional consequences, government has a role in addressing these concerns.

As my EIA colleague pointed out, the expanded oil producing cartel, including Mexico, restricted production, to address concerns of oversupply and large inventories. When combined with increased demand from Asian economies coming out of recession, there was a dramatic increase in oil prices and large increases in domestic prices for a number of refined products, notably home heating oil.

This administration has moved forcefully to deal with current price movements. Secretary Richardson has coordinated the administration's efforts in this regard. Actions included the following: releasing additional LIHEAP money—$295 million in emergency funds that will help low-income Americans pay their heating bills this winter. The administration also submitted to Congress a supplemental request for additional funds—emergency funds for LIHEAP, to get through the end of the fiscal year. The administration assured availability of SBA loans for heating oil distributors, to help with their cash-flow. The administration worked with States on a case-by-case basis on possible Clear Air Act waivers, in order to ensure that fuel oil supplies were available. The administration obtained hours of service waivers, to enable truckers to work extended hours to deliver products safely. The administration urged refiners to defer routine maintenance turnarounds, so that heating oil production will be adequate to meet demand during the heating season; also, the administration urged electricity generators to switch from heating oil to natural gas where possible.

The Department began a process to reestablish an Energy Emergency Office, to enable the Federal Government to work more closely with States, and to anticipate, plan, and respond to energy problems. The administration created a DOE-U.S. Coast Guard task force for product movement, to make sure there were no shipping delays for heating oil. And the Department directed the strategic petroleum reserve office to renegotiate oil delivery contracts for the reserves royalty in kind program, to ensure that more oil stayed on domestic markets in the near term. We also sought additional weatherization funds for fiscal year 2001 and, also, a supplemental request for fiscal year 2000.

Secretary Richardson hosted a home heating oil summit in Boston on February 16, to bring together congressional members, State officials, industry leaders, to discuss methods to address the price run up.

In addition, Secretary Richardson personally coordinated a strong diplomatic effort, to show oil producers that supply restrictions are harmful not only to oil consuming countries, but, also, to the oil exporting countries, themselves.

The culmination of these discussions with energy administers from Saudi Arabia, Kuwait, Mexico, Norway, and Venezuela was the release of a number of communiques that shared a common theme: volatility in oil markets is not desirable; it is damaging to both consuming and producing nations. Moreover, these countries agreed that upcoming production decisions by OPEC and its oil producing colleagues will take into account the implications of current production levels on the world economy. We are guardedly optimistic that when the OPEC ministers meet at the end of March, that there would be substantial and timely increases in production.

We should not focus solely on production decisions by oil producing nations. Also, keep in mind that the Department has a long-term R&D effort aimed at cutting oil consumption without cutting the services that we get from petroleum products. These programs can help reduce dependence on foreign oil, by encouraging energy efficiency, developing alternative fuels, and supporting domestic oil production.

Total petroleum consumption in the United States is approximately the same as it was 20 years earlier. But, our per capita consumption has dropped by about a fifth and our energy consumption per dollar GDP has dropped by about a third. This has been achieved through a number of efficiency and alternative fuel efforts, which we plan to continue for the future. For example, the Department's transportation program is working with its partners in the Partnership for a New Generation Vehicles Program, to develop an 80-mile per gallon prototype mid-size sedan by 2004; to improve light truck efficiency by 35 percent, also by 2004; and to develop technologies to increase the economy of the largest heavy trucks from seven to 10 miles per gallon, almost a 50 percent increase. The Department has also worked to increase domestic ethanol production to 2.2 billion gallons per year by 2010.

On the domestic oil and gas side of things, the Department is working with industry to make efficient use of the resources we have in an environmentally responsible manner. The emphasis is on recovery technology, helping the private sector extract more usable oil and gas from existing reserves than we did in the past, and extending the life times of those reserves.

While some have argued for release or sale of oil from the strategic petroleum reserve as a way to bring down world oil prices, we do not believe that a release at this time would be desirable. The SPR's is intended for release only in the event of a major oil supply disruption, not for trying to manage the world market of nearly 74 million barrels per day. If you keep in mind that the strategic petroleum reserve is 570 million barrels, you can see it's far too small for the task of managing world oil prices.

In summary, we think the outlook is for lower world oil prices later this year. We're aware that high crude prices and low inventory levels can lead to higher gasoline prices this summer; however, we need—we think that we need to let the energy diplomacy efforts led by Secretary Richardson to work in the short term and then look to address our other concerns through long-term efforts that make the best use of markets to allocate energy resources.

Thanks for your attention. I appreciate your questions.

[The prepared statement of Mark Mazur follows:]

PREPARED STATEMENT OF MARK MAZUR, DIRECTOR, OFFICE OF POLICY, U.S. DEPARTMENT OF ENERGY

Mr. Chairman and members of the subcommittee: I would like to thank Chairman Barton for inviting the Department of Energy here today to testify on the recent movements in crude oil and petroleum product prices. At the Department of Energy, the Policy Office is responsible for providing objective analysis and policy advice to the Department's senior management. I am happy to be here today to speak on behalf of the Department.

One point I want to make clear is that the United States has a long-standing energy policy, followed for about 20 years by both Democratic and Republican Administration's. This energy policy is grounded in a general reliance on markets and prices to allocate energy resources. Usually, energy markets work well. However, when there are market imperfections or unwelcome distributional consequences of market operations, government has a role in addressing these concerns. That is why the government policy toolbox in the energy area includes items such as LIHEAP, weatherization, and the Strategic Petroleum Reserve.

THE SITUATION THIS YEAR

Cold weather, limited heating oil availability and rapidly climbing heating oil prices in the Northeast in late January and February alarmed consumers, distributors, and governments at all levels. And an expanded oil-producing cartel (OPEC plus Mexico and Norway) restricted oil production to address concerns with oversupply and exceptionally large inventories. As my EIA colleague has pointed out, these actions, combined with increased demand from Asian economies coming out of recession, led to a dramatic rise in world oil prices.

This Administration has moved forcefully at home and abroad to deal with both short-run and long-run causes of our current environment of "extreme" price movements. Following this winter's runup in price for distillate fuels in the Northeast, Secretary Richardson coordinated the Administration's efforts. The Administration moved to implement traditional programs and went beyond these initiatives to creatively help those in need. The Administration:

- Released additional Low Income Home Energy Assistance Program (LIHEAP) funds. The U.S. Department of Health and Human Services (HHS) released a total of $295 million in emergency funds to help low-income Americans pay their energy bills this winter. The bulk of these funds were targeted at Northeast states that had substantial fuel price increases.
- Submitted to Congress a supplemental request for $600 million to provide additional contingent emergency funds for LIHEAP through the end of the fiscal year.
- Ensured availability of Small Business Administration loans for heating oil distributors who needed improved cash flow in order to meet contractual obligations and make deliveries;
- Worked with states on a case-by-case basis on possible Clean Air Act waivers to help add to the quantity of available fuels ensuring that people had adequate fuel oil supplies;
- Obtained "Hours of Service" waivers that enabled truckers to work extended hours to deliver the product safely;
- Urged refiners to defer routine maintenance turnarounds. Recognizing individual refinery needs and safety requirements, the Administration urged trade associations and companies to delay routine maintenance so that heating oil production would be adequate to meet demand this heating season;
- Urged electricity generators to switch from heating oil to natural gas where possible;
- Began the process to reestablish an Energy Emergency Office at the Energy Department to enable the federal government to work more closely with the states to anticipate, plan and respond in a more immediate and coordinated way when energy crises occur, including heating oil/gasoline shortages, power outages, or pipeline emergencies;
- Created a DOE/U.S. Coast Guard Task Force for Product Movement, to prioritize heating oil shipments at terminals when necessary, clear rivers as needed, deploy Coast Guard vessels and other resources to make certain there are no shipping or loading delays;
- Directed the Energy Department's Strategic Petroleum Reserve Office (SPRO) to renegotiate oil delivery contracts for the Reserve's royalty-in-kind program to ensure that more oil remained on domestic markets;
- Directed the Energy Information Administration to increase its monitoring of home heating oil prices;
- Sought $154 million for low-income weatherization assistance in the FY 2001 budget and requested an additional $19 million in a supplemental request for FY2000;
- Announced regulatory changes to give nonprofit organizations more flexibility in providing weatherization assistance;
- Held a series of meetings with refiners, industry, consumers, and Northeast lawmakers; and
- Hosted a home heating oil summit in Boston on February 16 that brought industry leaders, congressional members and state officials together to address methods to address the price run-up.

To look at long-term solutions, the President has directed the Department to study the longer-term issue of heating oil supply shortages and price spikes by examining possible ways to reduce regional reliance on heating oil, mainly through the increased use of natural gas. Moreover, the Secretary has directed the Department to study the impacts of interruptible contracts on home heating oil supply.

John Cook provided you with an excellent overview of current supply restrictions by OPEC and its allies. Secretary Richardson has personally coordinated a strong diplomatic effort to show oil producers that supply restrictions, past some point, are harmful not only to oil consuming countries but also to the oil exporting countries themselves. In general, because OPEC does not control all the world's oil, the more successful OPEC is in restricting supply, and hence the higher oil prices, the more incentive is provided for non-cooperating producers to increase their output. As non-cooperating oil suppliers increase production to take advantage of higher prices, and consumers move away from high-priced oil, OPEC must either make further supply cuts to maintain price—thus losing market share—or maintain market share but give on price.

The culmination of this round of discussions with energy ministers and key leaders from Saudi Arabia, Kuwait, Mexico, Norway and Venezuela was the release of four joint communiques that shared a common theme: excessive volatility in oil markets is not desirable—it is damaging to both consuming and producing nations. And, while the communiques varied in substance from country to country, the single point on which all producing countries—Kuwait, Saudi Arabia, Norway, and Venezuela—agreed, was to reevaluate data on current oil market conditions to help avoid excess market volatility and preserve world economic growth. In other words, upcoming production decisions by OPEC and its oil producing colleagues will not be arbitrary—they will take into account the implications of current production levels on the world economy. We believe the likely outcome of this analysis will be shown when the OPEC ministers meet on March 27th—that there should be substantial and timely increases in production.

THE LARGER PICTURE

I think we should not focus solely on production decisions by oil-producing nations in the short term, but also keep in mind that the Department has a long-term, well-crafted research and development effort aimed at cutting our oil consumption without cutting the services we get from petroleum products. These programs can help mitigate energy price spikes and slow our rising dependence on foreign oil by encouraging energy efficiency, developing alternative fuels, and supporting domestic oil production. Although total petroleum consumption was approximately the same, in million barrels per day, in 1999 as 1979, our per capita consumption has dropped about one fifth and our energy consumption per dollar of gross domestic product has dropped about a third. This has been achieved through a number of efficiency and alternative fuel efforts which we plan to continue for the future. For example, the Department's transportation program is working with its partners to develop an 80 mile per gallon(mpg) prototype sedan by 2004; to improve light truck fuel efficiency by 35 percent while meeting newly issued EPA Tier 2 emission standards by 2004; to develop technologies to increase fuel economy of the largest heavy trucks from 7 to 10 mpg (nearly 50 percent) by 2004, and to increase domestic ethanol production to 2.2 billion gallons per year by 2010. The Administration is also supporting market incentives like the tax credit proposal for hybrid vehicles. These efforts will result in vehicles with higher fuel economy and increase the production and use of alternative fuels, both important avenues to reducing the potential for future oil price fluctuations.

The Department also is encouraging the domestic oil and gas industry to make efficient use of the resources we have in an environmentally responsible manner. The emphasis is on recovery technology—helping the private sector to extract more usable oil and gas from existing reserves than we did in the past. The Energy Department restarted its program to share the costs of field tests of new or improved technologies that keep endangered resources in production. This program has subsequently provided nearly $23 million in cost-sharing assistance to producers. Some elements of the Department's wide-ranging research program cover: improved drilling and completion techniques; use of new diagnostic and imaging tools; and improved techniques to improve the efficiency with which reserves are recovered and to increase useful reservoir life.

Clearly, we need to recognize that petroleum product price volatility is a periodic policy issue—particularly during times of New England cold snaps or supply cutbacks by overseas oil producers. With cost-driven lower inventory levels and electronic markets, petroleum product prices are responding immediately to market developments. While prices are excellent sources of information for all sorts of business and personal decisions, rapidly changing prices introduce uncertainty that has its own costs for consumers and producers.

While some have argued for release of oil from the SPR as a way to bring down world oil prices, we do not believe that a release at this time would be desirable. The SPR is intended for release only in the event of a major oil supply disruption, not for trying to manage the world market of nearly 74 million barrels per day. At

570 million barrels, it is far too small for that task. Releasing crude oil from the Strategic Petroleum Reserve now for future repayment in delivered oil—including a premium—could add crude oil to the current market and could be appealing to crude purchasers because of expectations that future oil prices will be lower than today's. We are evaluating this strategy as a possibly cost-effective way to increase the size of the SPR to address potential future supply imbalances. However, no decision on whether to undertake this policy option has been made.

SUMMARY

In summary, we think the outlook is for lower world oil prices later this year, as forecast by participants in the futures markets. We are aware that high crude prices and low inventory levels can lead to higher prices for gasoline this summer. However, we think that we need to let the energy diplomacy efforts undertaken by Secretary Richardson work in the short term and then look to address these concerns through long-term efforts that make best use of markets to allocate energy resources.

Thanks for your attention. I would be happy to answer any questions you may have.

Mr. BARTON. Thank you, sir. We now like to hear from the Federal Trade Commission. We have Mr. Richard Parker, who is the director of the Bureau of Competition. Your statement is in the record in its entirety. We want to thank for getting it in on time and would ask you to summarize it in 7 minutes or less.

STATEMENT OF RICHARD G. PARKER

Mr. PARKER. Thank you, very much, Mr. Chairman and members of the committee for asking us to participate. What I'd like to do is make basically three points that I hope will be helpful to the committee about the FTC and what we—what our capabilities are in this area.

The FTC enforces the antitrust laws. We share that responsibility with the Department of Justice. The Commission has been very active in enforcing those laws over a lot of years, in a lot of industries, including most prominently the petroleum industry and the energy industry, generally. We have a long history of enforcement actions. We are ready, willing, and capable to take on the industry, in the event they cross the antitrust lines that I'm going to describe in a moment.

Our most recent action would have been—is a challenge to the BP-ARCO merger, which is pending in Federal court in San Francisco and now scheduled for trial on March 20. I would add that in the EXXON-Mobil matter, we achieved divestitures of over 2,000 gas stations, refineries, and EXXON's marketing system in California, in order to ensure that that merger did not increase concentration in any American market.

The second point I want to make is about the antitrust laws, generally, that we're trying to enforce. The antitrust laws are about competition. They're the laws of competition and they're premised on the notion that's been part of American law for 110 years now, that consumers are best protected when companies are slugging out, to use the colloquial; fighting it out in the marketplace. And it's that interaction of force, that interaction of competitive forces that produce low prices, innovation, and increasingly good service.

What the antitrust laws do is intervene and what an enforcement agency does is intervene when companies or individuals attempt to opt out of the competitive system, which largely, and I'm speaking broadly, occur in three general kinds of instances. First is when they quit competing and start cooperating; collusion: agreeing on price, agreeing on output, and the like. That violates the antitrust laws and where that occurs and where we have a case to prove it, we have and will take action.

Point two would be monopolization, where one company grows to a level where it, alone, is so dominant, that it can raise price or reduce output and reduce service and get away from it, in attempts to preserve or extend that monopoly power with anti-competitive practices. And where that happens, the antitrust laws take hold and we have the ability and certainly the willingness to go after that, as well.

The third area is one that's been particularly active, because this country is in the throes of a merger wave that is of historic proportions, and that is the antitrust laws do not allow companies to merge their way to market dominance. And when that occurs, as we've seen in the EXXON-Mobil matter and in the BP-ARCO matter and a lot of other matters, the Commission has the resources and the willingness and the ability and the trial and other skills it takes, to take that on.

My final point is this, and it is somewhat frustrating, because I cannot talk, for a good reason, about ongoing investigations and so I can't get into detail about that, but the oil price increases are a serious matter, a very serious matter. We recognize that. Particularly compelling is the human side that has been presented by so many of the members this morning. We have good people, expert people looking at, for example, the oil price issues in California, and we're assisting, working with the States in the northeast, and we continue our vigil on the merger front. We have the people and we are paying attention.

I appreciate, again, the opportunity to participate in the hearing and I'd be please to respond to any questions you might have.

[The prepared statement of Richard G. Parker follows:]

PREPARED STATEMENT OF RICHARD G. PARKER,[1] DIRECTOR, BUREAU OF COMPETITION, FEDERAL TRADE COMMISSION

I. INTRODUCTION

Mr. Chairman and members of the Committee, I am Richard G. Parker, Director of the Federal Trade Commission's Bureau of Competition. I am pleased to appear before you today to present the Commission's testimony concerning the important topic of recent large increases in the prices of oil products, and what the various agencies of the federal and state governments can, and should, do in response. This is a national issue that calls for a coordinated response from all parties.

The FTC is a law enforcement agency whose statutory authority covers a broad spectrum of the American economy, including the companies and economic sectors that make up the energy industry and its various components. The Commission enforces, among other statutes, the FTC Act[2] and the Clayton Act,[3] sharing with the Department of Justice authority under section 7 of the Clayton Act to prohibit mergers or acquisitions that may "substantially lessen competition or tend to create a monopoly."[4] In addition, section 5 of the FTC Act prohibits "unfair methods of competition" and "unfair or deceptive acts or practices," thus giving the Commission responsibilities in both the antitrust and consumer protection areas. In antitrust cases not involving mergers, the laws enforced by the Commission generally prohibit two

[1] This written statement represents the views of the Federal Trade Commission. My oral presentation and response to questions are my own, and do not necessarily represent the views of the Commission or any individual Commissioner.

[2] 15 U.S.C. §§41-58.

[3] 15 U.S.C. §§12-27.

[4] 15 U.S.C. §18.

categories of anticompetitive activities—conspiracies in restraint of trade and exclusionary monopoly tactics. The Commission also provides advice and guidance to states and other federal regulatory agencies on competition issues.[5] Moreover, the Commission has experience in applying antitrust principles across many different industries.

Experience demonstrates that competition among market participants ordinarily will provide consumers with the benefits of low prices, desirable products, good service, and innovation. Certainly that is the case for energy products, including oil, natural gas, and electric power.

The Commission has had experience in enforcing the antitrust laws in each of these industries. The Commission has expended a substantial part of its resources in recent years on energy matters. In fiscal years 1999 and 2000 to date, the Bureau of Competition spent 115 work years on investigations in energy industries, almost one-third of its total enforcement budget. So far in fiscal 2000, the Bureau has spent over 35 work years on energy related matters.

II. THE COMMISSION'S EXPERIENCE WITH ANTITRUST ENFORCEMENT IN ENERGY INDUSTRIES

Much of the Commission's experience with enforcing the antitrust laws in energy industries has been in analyzing mergers. Merger enforcement is the first line of defense in protecting a competitive marketplace, because it preserves rivalry that brings lower prices and better services to consumers. The Commission blocks those mergers that increase the likelihood that the merged firm can unilaterally, or in concert with others, increase prices or reduce output or innovation. The Commission has an extensive history of carefully investigating mergers in the energy industries, particularly petroleum, and the FTC has challenged mergers in those industries that would be likely to reduce competition, result in higher prices, and injure the economy of the nation or any of its regions.[6]

The Commission has been particularly active in investigating petroleum mergers due to the ongoing trend of consolidation and concentration in this industry. On February 2, 2000 the Commission voted to challenge the proposed merger of BP/Amoco and ARCO.[7] In recent years, the Commission has investigated the mergers of Exxon and Mobil[8] and BP and Amoco[9]—the two largest oil mergers in history—and the combination of the refining and marketing businesses of Shell, Texaco and Star Enterprises to create the largest refining and marketing company in the United States.[10] Other recent mergers regarding petroleum industry assets include Tosco's acquisition of Unocal's California refineries and marketing business, the acquisition by Ultramar Diamond Shamrock of Total's North American refining and marketing operations, and the combination of the refining and marketing businesses of Marathon and Ashland.

Our investigations revealed that several of these transactions threatened competition in local or regional markets. In each instance, relief was obtained to restore the competition lost as a result of the merger in a wide range of markets from refineries to distribution to retailing. In retail markets in Exxon, the Commission ordered divestiture of all Mobil stations from Virginia to New Jersey, and all Exxon stations from New York to Maine, the largest retail divestiture in history. In addition, the Commission ordered additional retail divestiture in Texas and Arizona, the divestiture of Exxon's Benecia refinery and California marketing assets, the divestiture of Mobil's Boston and Manassas, Virginia terminals, the sale of the Exxon Plantation or Mobil Colonial pipeline interest, and the divestiture of Mobil's interest in the Alaska pipeline. In BP/Amoco, the Commission ordered divestiture to preserve retail competition in 30 local gasoline markets mostly in the Midwest, and in

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[5] In recent years, the Commission has been active in supporting the deregulation of the electric power industry. *See* Commission Letter to the Honorable Thomas E. Bliley, Chairman, Committee on Commerce, United States House of Representatives, Concerning H.R. 2944, The Electric Competition and Reliability Act (Jan. 14, 2000); Comment of the Staff of the Bureau of Economics, Federal Trade Commission, "Inquiry Concerning Commission's Merger Policy Under the Federal Power Act," Dkt. Nos. RM95-8-000 and RM94-7-001 (May 7, 1996); "Revised Filing Requirements," Dkt. No. RM98-4-000 (Sept. 11, 1998); Comment of the Staff of the Bureau of Economics of the Federal Trade Commission Before the Alabama Public Service Commission, Dkt. No. 26427, Restructuring in the Electricity Utility Industry (Jan. 8, 1999).

[6] Section 7 of the Clayton Act specifically prohibits acquisitions where the anticompetitive acts affect "commerce in any section of the country." 15 U.S.C. § 18.

[7] *Federal Trade Commission v. BP Amoco*, p.l.c., Civ. No. C 000416 (SI) (N.D. Cal. Feb. 4, 2000) (complaint).

[8] *Exxon Corp.,* FTC File No. 991 0077 (Nov. 30, 1999) (proposed consent order).

[9] *British Petroleum Company p.l.c.*, C-3868 (April 19, 1999) (consent order).

[10] *Shell Oil Co.,* C-3803 (April 21, 1998) (consent order).

Shell-Texaco, the Commission preserved competition through divestiture in local gasoline markets in San Diego and Hawaii, and broader refining and pipeline markets in the Pacific Northwest, California, and the Southeast.

The Commission has also challenged anticompetitive mergers in other energy industries, including electric power, coal, and gas pipelines. The Commission recently investigated three "convergence mergers"—where an electric power company proposed to merge with a fuel supplier. The first case concerned PacifiCorp's proposed acquisition of The Energy Group PLC and its subsidiary, Peabody Coal.[11] In a second case, the Commission filed a complaint against CMS Energy Corporation's proposed acquisition of two natural gas pipelines from subsidiaries of Duke Energy.[12] In Dominion Resources, the electric utility that accounted for more than 70 percent of the electric power generation capacity in the Commonwealth of Virginia proposed to acquire Consolidated Natural Gas ("CNG"), the primary distributor of natural gas in southeastern Virginia. Working closely with Commonwealth officials, the Commission required the divestiture of Virginia Natural Gas, a subsidiary of CNG.[13]

In each energy investigation, the Commission has carefully reviewed the proposed merger, and has intervened where appropriate to prevent those mergers from significantly reducing competition in any sector of this industry that affects the United States or its citizens. The Commission's inquiry has been, and continues to be, to determine whether a merger would make it substantially likely that the remaining firms in the industry could reduce output and raise prices to the detriment of consumers anywhere in the United States. Consumer protection is the goal of antitrust enforcement across all industries; its importance is particularly clear in the energy industry, where even small price increases can have a direct and lasting impact on the entire economy.

As an analytical matter, the Commission approaches its antitrust mission by examining the areas in which merging companies compete, looking at the existing state of competition in that marketplace and the likely changes in that marketplace in the future, both from new competition entering and from existing competition exiting. We also look at the effect of recent mergers on competition in the particular marketplaces at issue, and whether the merger is a part of a trend towards concentration. The Commission has recognized the existence of such a trend toward consolidation in the petroleum industry.[14]

We also consider whether a merger will yield efficiencies that might counteract the merger's threatened anticompetitive effects. However, efficiencies must be proven—merely claiming cost savings is not enough to allow an anticompetitive merger. The cost savings must be real, they must be substantial, they cannot result from reductions in output, they cannot be practicably achievable by the companies independently of the merger, and they must counteract the merger's anticompetitive effect, not merely flow to the shareholders' bottom line.[15]

The Commission has several active investigations of matters involving energy industries, both merger and nonmerger. Commission rules prevent comment on current investigations, but it is public knowledge that the Commission has filed a complaint against the proposed merger of BP/Amoco and ARCO and is also looking at the issue of gasoline pricing in California and other Western states.

III. THE CURRENT ECONOMIC ENVIRONMENT AND POSSIBLE GOVERNMENT ACTION

The last year has been a volatile one for energy prices in the United States, and that volatility has only increased in the first few months of this year. Based on publicly available information, we know that crude oil prices rose from $12 per barrel in February 1999 to over $31.00 per barrel by March 1, 2000.[16] On top of the crude oil price increases, the prices for heating oil and diesel fuel jumped sharply in the Northeast in January 2000. Between January 17 and February 7, prices of New England residential heating oil prices rose from $1.18 to $1.96 per gallon, while New England retail diesel prices rose from $1.44 to $2.12. Just as quickly, however, prices have begun to come down. By February 21, the price for retail diesel fuel fell

[11] *PacifiCorp,* FTC File No. 971 0091 (consent order accepted for public comment Feb. 17, 1998). This order was withdrawn when the parties abandoned the transaction.

[12] *CMS Energy Corp.*, C-3877 (June 2, 1997) (consent order).

[13] *Dominion Resources, Inc.,* C-3901 (Dec. 9, 1999).

[14] *British Petroleum Company p.l.c.*, C-3868 (April 19, 1999) (consent order), Analysis to Aid Public Comment.

[15] *See* United States Department of Justice and Federal Trade Commission, Horizontal Merger Guidelines § 4 (1992), *reprinted in* Trade Reg. Rep. (CCH) ¶ 13,104 (1992).

[16] Energy Information Administration, Heating Fuels and Diesel Update, March 2, 2000, at www.eia.doe.gov. *See also* Martha M. Hamilton, "Three Major Oil Producers Consider Increasing Output," Wash

to $1.74 per gallon and the heating oil price also dropped.[17] What are the causes of high prices and substantial price volatility, and what can competition enforcement agencies do to ameliorate them?

It is no secret that the United States is dependent on foreign sources for a major portion of our petroleum consumption. That reliance is growing. In 1998, net imports of crude oil supplied approximately 52 percent of U. S. demand—the highest percentage ever. Despite the rising use of alternate fuels such as coal and natural gas, petroleum still provides 39 percent of the country's energy needs.[18]

Higher petroleum prices in 1999 can be traced to several factors. OPEC countries and several other non-OPEC exporting countries curtailed supply. Simultaneously, a number of Asian economies began to recover from a regional recession, causing increased demand for petroleum products. The result was that worldwide consumption exceeded production and inventories were drawn down. The price increase caused by the excess of demand over supply also reduced refinery margins, causing refiners to cut production and use inventories to meet demand.

The short term price volatility in the Northeast was probably caused by several different, or at least additional, factors, including weather and supply problems. Low inventories set the stage for price volatility as changes in demand had to be met from imports. At the beginning of January, East Coast inventories for distillates were about 8 percent below the low end of the normal range.[19]

The weather on the East Coast was also unusually severe in January. During the week of January 16, a cold spell hit the Northeast, dropping temperatures to nearly 20 percent lower than normal for that time of the year. The weather had a twofold effect: at the same time that it caused the demand for heating oil to increase, the cold weather decreased supply because frozen rivers and high winds delayed product movement. Demand for electric power also increased, causing utilities to turn to distillates as a substitute for interruptible natural gas supplies. Additionally, several refinery outages in January exacerbated the supply/demand imbalances.

While cold weather and refinery malfunctions raise no obvious antitrust issues, continued antitrust oversight of these markets is important to insure that market participants do not exacerbate those conditions through anticompetitive conduct. There are a number of potential activities that would violate the laws enforced by the Commission. Price fixing, tying, or agreements on supply reductions could all be antitrust violations. For example, if producers take advantage of market-determined events to overtly or tacitly collude on price increases or output reductions, the enforcement agencies should aggressively intervene. The potential is always present for producers, refiners, or distributors to take advantage of sudden market imbalances to engage in anticompetitive conduct in the hope that their illegal activities will be lost in all the noise.

There are certain markers or evidentiary patterns that the Commission staff looks for when deciding whether or not to open an investigation. Evidence of overt collusion may point to anticompetitive activity, but it is rarely observed. Where there is evidence of overt collusion, criminal enforcement may be appropriate.[20] Where there is evidence of tacit collusion, a closer look also is warranted. Many factors may show tacit collusion, but generally we look for evidence that firms are acting contrary to what would seem to be their independent economic interests. For instance, if some or all firms in an industry are shipping from high margin markets to low margin markets, that may be some evidence of an agreement. If price and cost movement are divorced from each other, that may also be evidence that competitive forces are muted.

It is crucial to separate anticompetitive conduct from market-driven outcomes so as not to chill competitive conduct. Large price increases are not themselves inconsistent with competitive behavior. They may merely be a competitive reaction to large cost increases. Without evidence of concerted activity or exclusionary monopoly conduct, there can be no antitrust violation.

The January price spikes were principally a Northeastern phenomenon. Crude oil prices for Gulf Coast and West Texas Intermediate crude did not increase materially; Midwest heating oil prices increased only 10 cents per gallon. A number of

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[17] Statement of John Cook, Petroleum Division Director, Energy Information Administration, Department of Energy, before the Committee on Energy and Natural Resources, United States Senate (Feb. 24, 2000).

[18] *Id.*

[19] The low inventories were likely a response to both high crude prices and an expectation that those prices would come down. If refineries had expected crude prices to continue to rise, it would have made sense to continue buying instead of reducing inventories.

[20] The Department of Justice has brought a number of criminal enforcement proceedings against international price fixing cartels in industries such as food additives and vitamins.

State Attorneys General in the Northeast have opened an investigation of the increase in prices for heating oil and diesel fuel in their jurisdictions and have requested that the Federal Trade Commission assist them. Beyond stating that we are providing such assistance, I cannot comment further on this law enforcement investigation.

IV. CONCLUSION

The Commission thanks the Committee for holding this important hearing. The American public needs to know what forces are at work in this vital sector of the economy. Higher prices for products that are critical to our citizens' quality of life and for the efficient functioning of the national economy are a matter of serious concern. Where conduct that violates the antitrust laws is implicated in the higher prices, enforcement action must be taken.

The Northeastern Attorneys General's investigation, assisted by the Federal Trade Commission, should enable us to determine if the reasons for recent increases in the price of heating oil warrant enforcement action.

Mr. BARTON. We thank you, Mr. Parker. The Chair is going to recognize himself for the first round of questions. They will be 5-minute rounds, but we'll have as many 5-minute rounds as members want. And with only three members here, I think we all have our chance to get the questions in.

My first question is to Dr. Cook and to Mr. Mazur of the Department of Energy and EEI. When did the Department sense that there might be a tightening of crude oil supplies coming into the United States? You showed us some pretty fancy charts, where you're predicting continued tightness in supply and, therefore, projecting increased gasoline prices at retail, which leads me to believe you do have a model that makes predictions or projections in advance. So, my question is: when did the Department sense that we were going to have this tightness in December and January, which did, in fact, result in a run up in fuel oil prices and gasoline prices?

Mr. COOK. As you may know, the Department has a monthly short-term forecast that comes out the first week or so of the month. The apparent impact on crude oil inventories from the imbalance and global supply and demand began to show up as significant by June—June and July.

Mr. BARTON. Last June and July.

Mr. COOK. Last June and July, in the data. The forecast began to reflect that, which go out on the Web. The published version is twice a year, April and October, I believe. I'd actually like to read you a quote, if I might, from the November forecast, which indicates some concern about price volatility.

"Price volatility in the spot and futures markets for both crude oil and natural gas has been the norm since the end of the summer, as the market has tried to anticipate the fuel requirements for the upcoming heating season. Changes in both the current weather and in short-term forecasts of the weather, particularly for the northeast and Midwest regions of the country, have caused heavy price fluctuation in these heating fuels markets. These weather factors are likely to continue to cause wide price swings in the spot and near-term futures markets for oil and gas through this end of the month, even before the heating system begins."

Mr. BARTON. That wasn't until November.

Mr. COOK. That was in the November forecast.

Mr. BARTON. Well, my point is: EIA has got some fairly sophisticated models. It would seem to me that if back in June, July, your models began to project the shortage in the fall and winter, it would have been prudent to schedule meetings with the Secretary of Energy and the President, and then, in turn, have them get with the State Department and work with the non-OPEC member states, like Mexico and others, that perhaps could increase production, so that you can have an increase in crude oil supply. Because, if you wait until November, December, even with the best of intentions, it takes a while from the time a decision is made to increase production, actually get the crude oil to the refinery and get the refinery to process it and send it through the distribution channel. So, why didn't the administration began to act a little bit more rapidly, if, in fact, you had indications last spring and summer, that the problem that has occurred might occur?

Mr. COOK. If you recall that stock chart that I had up there, you may remember that even as late as November—the end of November, distillate inventories and inventories were still in the normal range. So, while we put out that warning in the forecast, we still had adequate inventories, by any measure. The problem in the northeast happened very rapidly and you really didn't have cause to go out and say the sky is falling, so to speak, until, essentially, right when the impact hit, with the cold weather in late January.

With those normal stocks in November, there were signs that if these trends were to continue, and that's why the language that I read to you, if, in fact, the stocks were to get low by January, the implication here, and you combine that with cold weather, you could have some volatility for the second half of the winter. But no one, not us or anyone else, can forecast cold weather and some of the other complications that occurred there.

Mr. BARTON. But, you can predict that it's probably going to be colder in December or January——

Mr. COOK. We were trying to predict that the stage——

Mr. BARTON. [continuing] than it is in June or July.

Mr. COOK. [continuing] was being set, but we couldn't take it any farther than that.

Mr. BARTON. Well, I——

Mr. COOK. Now, that said, I agree, you know, the process of communicating these concerns certainly can be and should be improved and we would like to work on you on that.

Mr. BARTON. Okay.

Mr. MAZUR. Mr. Chairman, I just want to interject one point, is that the data that we rely on for worldwide supply and demand measures comes with quite a lag, a several month lag. The data that John showed you for the United States comes very quickly. Basically, we have the best data system at the Energy Information Administration in the world. Everybody else is not so good. And so a lot of the work that John's folks are doing on forecasts is based on older data from other parts around the world and then their best judgment of what that is likely to show. And so when we get concerns, as John read, they tend to be tempered, because we don't have a very precise feel for what the worldwide stocks of crude oil are.

Mr. BARTON. Well, my prediction is, based on the hearing today, since it's being televised, DOE projecting higher gasoline prices in the summer, that impact is going to be felt on the spot market this afternoon. It was probably felt in minutes after that went out. So, you know, we really need to do a better job. Because, if you try to increase supply, the only way we have to increase supply in the short run in the United States is greater imports. And given that OPEC has a cartel that is trying to restrict production right now, we have to work with our non-OPEC allies that are just observers: Mexico and Russia, some of those nations. So, we really need to develop a better mechanism, when your model show a projected tightness, to do something other than economists sit around conference tables and cluck about it. I mean, I would hope you would agree with that.

Mr. COOK. I agree. I said that we should improve this process and we'd like to work with you.

Mr. BARTON. My last question, because my time has expired: what are fuel oil prices today in the northeast? We've heard the testimony from our congressional panel of $1.80 a gallon and there's anecdotal evidence that it is $2 a gallon. I'm told that that price has already come back down and the numbers that we have on the staff, they were about $1.17 a gallon for fuel oil. Does that track with what you have?

Mr. COOK. No. I think I testified that in New England, heating oil prices rose about 75 cents a gallon and over the balance of February, they had dropped about 60 cents, as of our last survey at the end of February.

Mr. BARTON. So, they are 15 cents a gallon higher?

Mr. COOK. So, they're still elevated, about 15 cents.

Mr. BARTON. And where was your base? Was it 90 cents a gallon?

Mr. COOK. That would put them in the $1.35 to $1.60 range, depending on the State.

Mr. BARTON. Today?

Mr. COOK. As of the end of February.

Mr. BARTON. Okay. What about as of today.

Mr. COOK. Well, we did a survey on Monday and the data will be available and published tomorrow. I just don't have it.

Mr. BARTON. But, is it a fair assessment that, as of today's hearing, the prices have declined from the highs that caused the greatest concern to some of the congressmen from the northeast?

Mr. COOK. Most of that increase has been offset.

Mr. BARTON. My time has expired. I'll get into the distribution channel in the next round of questioning. Mr. Boucher of Virginia.

Mr. BOUCHER. Thank you, very much, Mr. Chairman. I agree with the statements that have been made by a number of members of this panel this afternoon, that it's important that witnesses present their testimony in a timely fashion. However, let me say in defense of DOE on this particular occasion, that the Department is testifying today before four committees of this Congress, and I would, also, point out that at least three members of the panel to follow did not present their testimony in a timely fashion either. I think we all can improve our practice, in this regard, and I would hope we would do that.

Mr. Mazur, let me ask you a couple of questions about the strategic petroleum reserve. There is a statutory mandate that the reserve have 1 billion barrels of petroleum. The actual capacity of the reserve today is about 700 million barrels, as a consequence of one of the facilities some time ago having leaked and that facility is today closed; so the real capacity is about 700 million barrels. At the present time, the inventory in the reserve is about 570 million barrels. Do you believe that it's in the public interest to utilize the full capacity of 700 million barrels that we have available and find the means to acquire the additional 130 million barrels necessary to fill it?

Mr. MAZUR. One of the steps that Secretary Richardson directed the Department to take last year, when prices were low, was to find innovative ways to add to the strategic petroleum reserve. And the one chosen was to use a royalty in-kind program: while prices were low, to add some oil to the strategic petroleum reserve, thinking that was a good deal for the taxpayer; when prices are high, it's probably not such a good time to be adding oil to the reserve. So, these are the steps that we're taking now. The strategic petroleum reserve competes with every other priority that Congress funds and there have not been a lot of appropriated moneys forthcoming to add oil to the SPR.

Mr. BOUCHER. Well, I'm going to get to a potential way that we might add to the reserve without having to have appropriated moneys; but, let me just get you to say whether you think it's a good idea for us to add to it, at this time. Assuming that the funding environment permitted that, do you think it's a good idea?

Mr. MAZUR. The administration is engaged in an SPRO sizing study, at that moment. I think it would be premature to come out one way or the other on that, until the actual analysis is completed.

Mr. BOUCHER. Well, I notice from your testimony a suggestion that DOE is presently considering, something that you call a lending plan, under the basic structure of which petroleum would be loaned from the reserve, at the present time, to petroleum companies. Those companies, presumably, then, would sell that petroleum into the market, with the beneficial effect that that would add to the supply and, presumably, affect price in a favorable manner. And, then, that petroleum would be returned to the reserve with interest, if you will, with a premium, meaning that more gallons would be put into the reserve than were withdrawn. And the return of the petroleum would, presumably, occur at a time when prices are lower and when the petroleum, therefore, can be purchased by the companies for less than they would be selling it for today. Now, this strikes me as a very innovative proposal. Among its benefits would be that the premium paid by the petroleum companies would actually serve to increase the size of the inventory.

Now, your testimony suggest that that is being considered by the DOE. So, let me just get you to elaborate on that a bit and why don't you start by telling us whether you think it's legally authorized, this proposal.

Mr. MAZUR. I think first, we do believe it is legally authorized. There have been other types of arrangements where oil has been traded, exchanged, in the past, and we think it's well within the authorization of the SPR. I think it's included in EPCA.

Second, whether it's a good idea or bad idea is being discussed right now. It's, again, under active consideration. It's an innovative program, as you say, and it's something where the details need to be worked out. And the details are quite important, in part, determining whether or not you're getting a good deal, in terms of the amount that is getting put back in the SPR, in the future. It's something that's not obvious to a casual observer.

Mr. BOUCHER. Well, let me simply encourage you to continue to refine this concept. It strikes me as creative thinking. I think it's entitled to more careful consideration. I would like to have the benefit of your thinking about the basis on which it is legally authorized. And I will conclude my questions with this, my time has expired, and that is following the OPEC meeting to take place later this month, during which it is hoped that the OPEC member nations will decide to increase petroleum production levels. If they do, by the way, I think that will be a direct consequence of the very favorable steps taken by our Secretary of Energy, to discuss that very process with the leadership in the petroleum exporting countries.

But following that meeting later this month, is it the intention of DOE to reevaluate your strategy, with regard to oil prices, and do you think you might be forthcoming with some additional recommendations to the Congress or a decision to take some additional steps, yourself, following that meeting, given the virtual certainty that gasoline prices will increase no matter what happens at OPEC at the end of this month?

Mr. MAZUR. I think the President said that all options are on the table and I think the he's encouraging a lot of creative thinking within the administration, as to what steps can be taken. I don't want to go too far out on this, though, when you talk about our policy toward energy prices. Really, the policy is to let prices and markets be set by supply and demand, and not have the government intervene and say price should be x. That's not part of the——

Mr. BOUCHER. Well, that, in and of itself, is a strategy with regard to energy crisis.

Mr. MAZUR. Probably a failed one.

Mr. BOUCHER. Well, that's fine. Thank you, very much, Mr. Mazur. Thank you, Mr. Chairman.

Mr. BARTON. Thank you, Congressman Boucher. We recognize Congressmen Burr for 5 minutes.

Mr. BURR. Thank you, Mr. Chairman. I want to say—it is Mazur?

Mr. MAZUR. Mazur, yes.

Mr. BURR. Mazur. Mr. Mazur, hopefully, you can give that same speech about our policy not being one to influence prices the next time we talk about some of the onerous regulations that we place on individuals in the energy field, because I think we do have a great effect on where the pricing is.

Let me turn to Mr. Cook, first. EIA missed their projections in a February letter on where gas prices were going to go. Would you care to give a new estimate today on what the peak is?

Mr. COOK. No. The one I just gave is our current projection.

Mr. BURR. And that is what?

Mr. COOK. $1.56 peak in May, up to $1.80, with the volatility that's out there.

Mr. BURR. And the basis for your peak number is on what OPEC has or has not done, or what DOE is going to or is not going to do? Is it on policy or is it on the OPEC decision?

Mr. COOK. Like all forecasts, it makes some assumptions.

Mr. BURR. What are those assumptions?

Mr. COOK. We assume that OPEC, one way or another, will increase production beginning April 1, by a million barrels a day. That may not be enough to fully balance crude markets and, therefore, that's one of the reasons why the forecast calls for continued high crude prices. That influences the gasoline price. The tightness in the gasoline market, itself, independent of the increase we might see in crude, is due to low stocks, high requirements for feed stocks——

Mr. BURR. But, you're presuming in this calculation that there's no policy or move that we make in this country that would stabilize the price?

Mr. COOK. No, we don't do that.

Mr. BURR. So, do you consult with DOE when you do your assumptions?

Mr. COOK. No.

Mr. BURR. Okay. Let me go back to you, if I could. We've had this discussion about SPR. It's on the table; it's off the table; it's on the table; it's off the table. Tell me what is different now than in 1995 or 1996, when we sold SPRO to raise revenues for budget purposes?

Mr. MAZUR. In those years, Congress directed the Department to sell a limited amount of oil from the strategic petroleum reserve. I think it was on the order of——

Mr. BURR. Congress approved the ability to sell oil at the request of the administration.

Mr. MAZUR. The administration requested it one time in the fiscal year and Congress——

Mr. BURR. And the administration requested it to raise revenues, so the budget would balance; yet, we're hesitant to sell any SPR to stabilize the price of oil prices.

Mr. MAZUR. My recollection is that the administration requested funds, so that the Weeks Island facility could be decommissioned and that Congress approved those funds. And then in subsequent years, Congress directed the Department to sell oil——

Mr. BURR. When we sell off SPR, do we affect the price of oil in the marketplace?

Mr. MAZUR. Actually, we did a quick little analysis, looking at the timing of the strategic petroleum reserve sales and what the effects of prices are and except for the Gulf War sale, it's difficult to see a dramatic drop in price coincident with the sales from the SPR.

Mr. BURR. So, we could estimate the effect that SPR sales were going to have on the world supply and, consequently, the cost in the United States of oil; but, we couldn't anticipate what would happen if OPEC cut their production, that we would be at $1.60 a gallon on gas?

Mr. MAZUR. I think part of what the forecast from the Energy Information Administration does is assume some production paths for various countries in the world: OPEC, non-OPEC producers, United States, and others. Sometimes, they are right; sometimes, they are a little short; sometimes, they are a little over. The EIA forecasts have consistently called for higher crude oil prices then in the month those forecasts are made. They may have undershot the extent to which prices were going to rise; but, they're pretty much on the mark, saying that fuel prices were going up.

Mr. BURR. You don't anticipate DOE to make any moves prior to the OPEC meeting the end of March?

Mr. MAZUR. Moves in which direction, sir?

Mr. BURR. Any direction.

Mr. MAZUR. You mean like selling SPR oil?

Mr. BURR. Making a decision to sell SPR or not sell SPR, or anything that would affect the stabilization of the price?

Mr. MAZUR. I think at this point, we think it's—the best course of strategy, to let Secretary Richardson's energy diplomacy work its way and see what——

Mr. BURR. Which is to wait for OPEC to have their meeting.

Mr. MAZUR. At the end of the month, yes.

Mr. BURR. So, we will continue Federal subsidies to those individuals, who are having a tough time affording fuel oil, and we'll extend SBA loans to truckers, who can't pay for the price of diesel. Now, how do we expect them to pay back those loans?

Mr. MAZUR. I think in the forecast that both EIA made and a number of private sector folks have made, oil prices are expected to come down probably by the end of the year or later.

Mr. BURR. And somehow they're going to recover enough money in additional profits to pay off loans that they've now incurred, because we've extended SBA loans to them?

Mr. MAZUR. That would be the expectation, yes, sir.

Mr. BURR. I will conclude, Mr. Chairman, because I have to go to another hearing. I would, also, tell you that with the accuracy of EIA's projections, I'll let you tell that to truckers across America, because I'm not going to be the one to give them that assurance that it's coming down. I thank you, Mr. Chairman.

Mr. BARTON. Thank you, Congressman Burr. We'll now recognize Mr. Wynn of Maryland for 5 minutes.

Mr. WYNN. Thank you, Mr. Chairman. I recognize that we don't have a representative from the State Department here, but I would like for you to share any information you may have on the subject of Russia's role in the OPEC decisionmaking, with regard to increase in production. The information that seems to be floating around suggests that Russia is one of the major obstacles to getting an OPEC agreement. Is that accurate?

Mr. MAZUR. This is not an area that I'm an expert on. I do know Russia is not a member of OPEC, so I would be surprised if they were a major obstacle to OPEC coming with an agreement.

Mr. WYNN. What about Russia, in general, are they—what role are they playing, in general?

Mr. MAZUR. Again, that's something that is outside of my area.

Mr. BARTON. Would the gentleman yield?

Mr. WYNN. Certainly, Mr. Chairman.

Mr. BARTON. I mean, it's true, they're not a member of OPEC; but, isn't it, also, true that they are regular observers at OPEC meetings and that there are meetings at the staff level between the oil ministry in Russia and the oil ministries in the OPEC countries?

Mr. MAZUR. They are a major oil supplier, so, yes, you would expect them to be sitting in——

Mr. BARTON. So, the Congressman's question, you know, does have merit, since Russia is one of the few non-OPEC members that could increase production, if they were so inclined?

Mr. MAZUR. Perhaps, yes.

Mr. WYNN. Thank you, Mr. Chairman. In your strategy discussions, have there been any consideration of negotiating with Russia? Are you aware of any negotiations with Russia, to increase their production?

Mr. MAZUR. I am not, no, sir.

Mr. WYNN. Early on, many of us expressed concern about the problems in the northeast with heating oil and there's a bill around, in which many of us believe that we ought to have a northeast or a regional reserve for domestic consumption of heating oil. What is your position on that?

Mr. MAZUR. The Department has looked over the past decade a number of proposals for regional refined product reserves and generally found that the expected cost of those reserves exceeded the benefits that would come from it. Secretary Richardson wants us to think creatively about alternatives, and so we are going to be spending a little bit of time to see if we can find a better approach. But, frankly, the analysis that has been done over the past decade has not been very supportive of the idea of having a regional petroleum——

Mr. BARTON. Would the gentleman yield on that point?

Mr. WYNN. Certainly, Mr. Chairman.

Mr. BARTON. Is it not true that the Department submitted to the chairman of this subcommittee a proposal that would eliminate the current authority to put funds into the regional reserve that was authorized in 1992?

Mr. MAZUR. Yes, I understand that.

Mr. BARTON. So, your official position is that you want to eliminate the existing authority?

Mr. MAZUR. And that would have been based on the most recent analysis that had been done of a regional product reserve.

Mr. BARTON. Thank you.

Mr. WYNN. You said the costs outweigh the benefits. How was that analysis done? I mean, as somewhat laypersons, we're assuming that the benefit would be that families would get heating oil, particularly low income persons, who would be impacted. That's the benefit. What are the costs considerations that were used to say that this was not a good idea?

Mr. MAZUR. There are a number of costs that are involved in creating and operating a regional product reserve. First, you need to acquire the facilities where the product is going to be stored.

Mr. WYNN. If you assume these are leased facilities.

Mr. MAZUR. You still have to pay the lease payments for that. Then, you need to acquire the product, and with refined product, one of the things you need to do is be in the market fairly regularly, to maintain a product that is of sufficient quality to be sold in the marketplace. So, the operating costs could be quite substantial. In addition, the analysis showed that it's not every year in which you would choose to use this facility. It would be on the order of one out of three winters, perhaps, that were cold enough and where the prices had spiked enough that you would want to make use of these reserves.

Mr. WYNN. It would appear that that would be a good thing; that that would kind of stabilize or help maintain the reserve, so that you wouldn't have to constantly make maximum purchases.

Mr. MAZUR. Not maximum purchases, but you need to keep the supply of the refined product relatively fresh, and so you would have to be in the market pretty regularly. So, you would be incurring operating costs on a regular basis.

Mr. WYNN. Let me ask two final questions: one, and this may be the same question in another guise, if this is not a good idea, what are your proposals to address the concerns of the northeast; and second, what are you long-term plans to make us more self-reliant, in view of these kind of periodic problems that we're encountering now and that we may well encounter in the future?

Mr. MAZUR. On the first question, what are we doing about the situation in the northeast, Secretary Richardson has directed the Department to look at a couple of issues. One is decreasing the reliance on fuel oil in the northeast, perhaps by increasing the use of natural gas there and try to understand what sort of obstacles there are to that switch in fuels. In addition, in the longer term, as I mentioned in the testimony, the Department has a fairly robust R&D program in energy efficiency, alternative fuels, and so on, which are designed to reduce our reliance on imported oil. On the domestic supply side, we have a fairly robust R&D program to help improve the amount of resource that can be extracted from existing reservoirs.

Mr. WYNN. What specific alternatives are you talking about?

Mr. MAZUR. On alternative fuels?

Mr. WYNN. Yes.

Mr. MAZUR. It would include things like—well, in transportation fuels, ethanol would be a top candidate. Biodiesel, as Ms. McCarthy mentioned earlier, is another one. And there are natural gas, methanol, and other types of fuels that can be used for transportation vehicles.

Mr. WYNN. All right, thank you.

Mr. BARTON. Thank you, Congressman, those were excellent questions. We would now welcome 5 minutes of questions from the gentleman from Georgia, Mr. Norwood.

Mr. NORWOOD. Thank you, Mr. Chairman, I appreciate that. Mr. Mazur, I'm, basically, going to confine my first full minute to you. Two days ago in the White House briefing room, the President, in his remarks, said he prefers high oil prices, because they're useful in supporting his social and environmental agenda. And just so I can get this exactly right, I'd like to quote the President, so we won't be off base here. He said, "Americans should not want oil prices to drop to $10 to $12 a barrel, the levels that they were last year, because that would take our minds off of our business, which should be alternative fuels, energy conservation, and reducing the impact of all of this global warming." Do you support that?

Mr. MAZUR. What the President, I think, was saying is that——

Mr. NORWOOD. I understand what he is saying.

Mr. MAZUR. Okay.

Mr. NORWOOD. Everybody in this room understood it. Now, do you support that?

Mr. MAZUR. I support the position that when prices last year at historic lows, that they took away the incentive for folks to give consideration to things, like energy efficiency and use of alternative fuels.

Mr. NORWOOD. Does the Department of Energy, then, and the Secretary support this statement that the President made, that anybody I know can understand?

Mr. MAZUR. Secretary Richardson has said, and he said many times last year, I think even in front of this committee, that prices—oil prices of $10 a barrel were too low. He's, also, said prices——

Mr. NORWOOD. Does that mean he, then, supports that price of gasoline at $1.80 a gallon?

Mr. MAZUR. That—that—no, I don't think that's what it means. It means that at $10 a barrel, the incentives for domestic production were sufficiently low, that not a whole lot of it was occurring.

Mr. NORWOOD. It's a little hard to have it both ways. The administration, in particular the Vice President, called for a 50 cents a gallon Federal tax hike, as part of the Clinton-Gore 1993 tax increase. Now, the administration, at that time, justified the request on grounds that higher prices would force the public, especially low income families, to use less energy. Public outcry, as you remembered, I certainly do, and I wasn't up here, forced the administration to drop this idea.

Now, the administration publicly supports allowing at least part of this OPEC price gouging to become permanent for the very same reason, forcing the public to use less gas by simply pricing low income working families out of the gas lines, which is what it does. Has anyone in the administration discussed any portion of this policy with you or other personnel at the Department of Energy?

Mr. MAZUR. I don't think anyone has discussed the idea of supporting OPEC to raise prices on American consumers, as part of a U.S. strategy, no.

Mr. NORWOOD. Were you in the Department of Energy in 1992-93, when——

Mr. MAZUR. In 1993, I was working for Joint Tax Committee, and I was working on the——

Mr. NORWOOD. Ah-hah, then you recall them wanting to increase prices 50 cents a gallon, so people would use less gas; in other words, pay more.

Mr. MAZUR. My recollection was that it was a broad-based energy tax, not just a gasoline tax.

Mr. NORWOOD. Well, that was certainly the part out of the broad-based tax that got dropped out, because the American people said, in a fairly loud voice in 1993, no, you don't; you're not going to do that.

Does the Department of Energy believe that higher oil prices, either through direct taxes or by default through international trade agreements, should be used as a tool to force the public to drive less? If so, does this amount to the same thing, enacting of 50 cents a gallon tax hike without having to seek congressional approval? Does it mean the same thing?

Mr. MAZUR. Again, I don't——

Mr. NORWOOD. If you're supporting higher prices, which means it's going to be higher at the gas tank, doesn't that, in effect, mean the same thing as raising the Federal excise tax by 50 cents?

Mr. MAZUR. No, I don't think so. I think one thing you need to keep in mind is that last year, when prices were $10, $11, $12 a barrel, those were historic lows, not seen since the days of the depression in the United States, in real terms. And I think it was commonly agreed that prices at that level were too low.

Mr. NORWOOD. So, you're, basically, saying that it's all right for the price to go up; it just may be a little high now?

Mr. MAZUR. I'm saying prices now are, I think—quite clearly, prices now are too high, yes.

Mr. NORWOOD. In your statement, you said, and I quote, "Oil prices will come down by the end of the year."

Mr. MAZUR. I think that's my expectation, yes.

Mr. NORWOOD. Do you mean by late October?

Mr. MAZUR. I think the price forecast that I've seen have shown them coming down throughout the course of the year; yes, sir.

Mr. NORWOOD. Well, explain to the public why you think they're going to come down?

Mr. MAZUR. I think the way I looked at this is the market participants, who purchase oil in the futures markets, for delivery in months of July, August, September, October, are willing to pay much less, $2, $3, $4 a barrel less for that oil than for today's oil. That's indication to me that the market believes prices will be coming down in the future.

Mr. NORWOOD. Did you predict the prices would go up as high as they're going?

Mr. MAZUR. As I said earlier, the EIA projections were fairly consistent that prices would be going up. I don't think they projected $32 a barrel oil.

Mr. NORWOOD. Dr. Cook, you said that——

Mr. BARTON. This will have to be your last question——

Mr. NORWOOD. It's very brief.

Mr. BARTON. [continuing] of this round.

Mr. NORWOOD. Very brief. Dr. Cook, you said that OPEC will increase production a million gallons a day and then you went on to say by one way or the other.

Mr. COOK. Barrels not gallons.

Mr. NORWOOD. I'm sorry, barrels. Explain to me what one way or the other would mean, so we can have some confidence this may be true. It doesn't appear there's going to be help from the Department of Energy, so what other ways are we going to hope to increase this production?

Mr. COOK. First of all, that was an assumption. The model works that way. We assumed a million barrel a day increase beginning in the second quarter. It doesn't mean that we have inside knowledge of anything like that. When I said one way or another, what I meant is that OPEC, after the meeting on March 27, may announce that. On the other hand, who knows what they're going to announce. It seems to change from day to day.

The other way that it can come out is just high prices tend to reduce their compliance with their own agreement. They tend to cheat more. And, in fact, that's why we underestimated all along the oil price, because we assumed that they would cheat more than they actually did. This is maybe a historic period for their unity, possibly dating all the way back to the early 1970's.

Mr. BARTON. That's true.

Mr. NORWOOD. Next round we'll finish.

Mr. BARTON. Thank the gentleman from Georgia. The gentleman from Massachusetts is recognized for 5 minutes.

Mr. MARKEY. Thank you, Mr. Chairman, very much. Mr. Mazur, in response to the gentleman from Maryland earlier, you said that DOE had done a recent study of the matter and you concluded that establishing a regional reserve was not cost effective. Now, if you're referring to your June 1998 study, then that just flat out contradicts what the conclusion was in your report, where it says that the expected benefits of a smaller 2 million barrel regional product reserve located in lease terminals in the northeast would approximate or exceed its costs. Is there some other study that you're referring to?

Mr. MAZUR. Yes, sir. I guess what I was saying was that there are a number of studies that have been done over the last decade and that the general conclusion——

Mr. MARKEY. No, I'm talking about is there some study more recent than your own study in June 1998?

Mr. MAZUR. That is the most recent study and under one scenario, it does conclude that the costs approximate the benefits. Under the other scenarios, I believe it concludes that the costs exceed the benefits.

Mr. MARKEY. So, when you said to Mr. Wynn that a regional petroleum reserve was not cost effective, were you referring to your own study, which says that it is——

Mr. MAZUR. I was referring——

Mr. MARKEY. [continuing] cost effective or are you referring to other people's studies that said that it may not be, Mr. Mazur?

Mr. MAZUR. Mr. Markey, I was referring to the bulk of the studies and I was referring to the general conclusion that comes from——

Mr. MARKEY. No, I'm talking about—you're not sticking by your own conclusions and in your own report, with regard to the economic feasibility of planting a petroleum reserve right in the northeast.

Mr. MAZUR. My understanding of that study is that you have one scenario in there, a 2 million barrel leased facility with oil swapped from the SPR, and that the conclusion and a particular strategy for using oil from that reserve. Under those sets of assumptions, their costs approximately equal the benefits. Under every other set of assumptions—under other——

Mr. MARKEY. Why don't you go forward with it, then, if it says that you can do it under this—under these conditions, using this scenario, it would be cost effective? Why isn't the administration moving forward on a program that you have concluded would be cost effective for the northeast?

Mr. MAZUR. I guess the point is that it would be approximately cost effective under the circumstances that are designed in there, including the assumed draw down plan, and it's not obvious to me that the assumed draw down plan would be one that the Federal Government would be utilizing.

Mr. MARKEY. Well, of course, they wouldn't be utilizing it, if they never wanted to deploy it in the case of a huge spike in the rates that the elderly and the poor in the northeast would have to suffer, because of the rise in home heating oil. If your whole belief is that you're never going to deploy it, in the event that consumers are getting hurt, then, of course, it wouldn't be effective. But, if you had it there and then there was without question a gouging of consumers, where they were being tipped upside down and had money being shaken out of their pockets by OPEC, by oil companies, and you deployed it, I don't think there's any question, based upon your own conclusions, that it would be an effectual use of taxpayer's money, in order to make sure that there was a rectification of a distortion of market forces.

Mr. MAZUR. I guess, sir, we disagree on the interpretation of that study.

Mr. MARKEY. Okay. Now, does the Department still want to repeal the provisions of the—of EPCA, that authorized DOE to create a regional refined product reserve, or have you changed your policy on that?

Mr. MAZUR. I understand that Assistant Secretary for Fossil Energy testified to that effect last year. I don't think that issue has been revisited.

Mr. MARKEY. So, now you're saying that you want to—you don't even want to build it at all, is that right? Is that the policy now with this administration, cancel it out?

Mr. MAZUR. I think that's what the Assistant Secretary testified to, but I don't know for——

Mr. MARKEY. Okay. Well, that's unacceptable. I mean, right now, I'm—what I'm—you know, the Christians had a better chance against the lions, than the consumers in the northeast are going to have against the OPEC and oil companies under this administration's oil policy. Now, we need a regional petroleum reserve to protect us against market distortions and you're telling us right now you have no intention of even revisiting this issue. And I think that maybe you are waiting it out, hoping spring hits early up in the northeast. But, it wasn't—it wasn't 85 degrees up there yesterday; it was 44 when I left. And you might get a little bit of a break, but you're only buying time before this issue comes back to haunt you again.

Now, instead of repealing this law, why don't we just reauthorize the test fill; that is, just do a little experiment up there. Norman Lent, the Republican from New York, and I passed that amendment back in 1990. Two years of the Bush Administration, no experiments; 2 years of the Clinton Administration, no experiments, and that legislation just lapsed. Why don't we reauthorize it, so you can have a chance to test? Would you support passage of legislation that reinstituted the Markey-Lent language, which gave you the ability to test?

Mr. BARTON. And this will have to be the last question of this round; but, if you want a second round, we'll certainly have a second round.

Mr. MARKEY. Thank you.

Mr. MAZUR. At this point, that's something that we would have to take under serious consideration. I couldn't commit one way or the other.

Mr. MARKEY. It's just unacceptable. Thank you, Mr. Chairman.

Mr. BARTON. The gentleman from New York, Mr. Fossella, is recognized for 5 minutes for questions.

Mr. FOSSELLA. Thank you, Mr. Chairman. Mr. Mazur, there is a direct correlation between the price of a barrel and the price of home heating oil and/or gasoline at the pump; correct—or Dr. Cook. In other words, the higher the price of a barrel, the higher the home heating oil——

Mr. COOK. Sure; sure——

Mr. FOSSELLA. It's just that——

Mr. COOK. [continuing] all other things equal.

Mr. FOSSELLA. I beg your pardon?

Mr. COOK. All other things equal.

Mr. FOSSELLA. Or, all other things equal. Now, this issue of the concern for the spike in prices, not on home heating oil in the northeast, but gasoline at the pump, has been on the table for several months now; correct? It goes back to November 1999?

Mr. COOK. I wouldn't phrase it quite that way, no.

Mr. FOSSELLA. December 1999? There were people raising the issue of releasing the strategic petroleum reserve back in November and December 1999, correct?

Mr. MAZUR. I think the chart that John Cook showed a little earlier had the distillate inventories still in the normal range in November 1999. So, I——

Mr. FOSSELLA. There were people advocating the release of the strategic petroleum reserves back in November and December 1999, correct?

Mr. MAZUR. I don't know.

Mr. FOSSELLA. You don't know?

Mr. MAZUR. Don't know.

Mr. FOSSELLA. Senator Shumer and others——

Mr. MAZUR. I'm sorry.

Mr. FOSSELLA. [continuing] who indicated——

Mr. MAZUR. Okay, I understand Mr. Shumer did, yes; so, at least—at least several people, yes.

Mr. FOSSELLA. I'm just—well, that is sort of disconcerting, because if there were—and he was just one them. There were others, who were raising this issue. I guess what I'm getting at is if we knew about in November of—December and you didn't, which is disturbing, but if you didn't and we had done something about it at that time, this quiet diplomacy that is now being discussed, if something was done then, wouldn't we be experiencing some relief in prices today?

Mr. COOK. As I indicated earlier, global inventories and U.S. inventories in November were still in the normal range. a lot of people were saying they were high then. What I tried to convey, maybe not as clearly as I should have earlier, is that the cuts in OPEC were beginning to cut into those surplus inventories and beginning to show a trend from high end to normal. Our models, everyone else's that I'm familiar with, assumed that OPEC would cheat more, supply more over the winter period, and that this trend would not necessarily bring inventories down to below normal. So, although Mr. Shumer did advocate use of the SPR at that point, the stock globally and in the United States were not even below normal.

And just the fact that they got below normal by mid-January did not produce the spiked price either. It was the combination of that, with cold weather, with some factors in the market that were pretty unusual that did that. We couldn't predict that in November. For all we knew, the stocks would start rising like they normally do in November.

Mr. FOSSELLA. But with all due respect, your analysis, it was wrong.

Mr. COOK. Absolutely. The actual——

Mr. FOSSELLA. And the fact of the matter, there were people advocating that somebody should step up on OPEC's toes, to increase production, because of a simple correlation between a price of a gallon—a barrel of crude oil and the price of home heating oil and the price at the gasoline pump. Nothing was done. Now, we're here today, that we should just wait until the Secretary's diplomacy takes hold. And isn't it a legitimate question that this should have been done 2, 3, 4 months ago, so that rather than wait until late October, November, December, the guy, who is filling up now, is paying $1.99 on Staten Island?

Mr. COOK. I can't speak to what should have been done. I can only point out, again, there's a lot of uncertainty in these areas and no one could know how much oil OPEC was going to actually supply over the winter. For all anyone knew, at higher prices, they could have supplied enough, that we would not have seen a continuation in that decline. Mr. Shumer's scenario, one of many out there, turned out to be the one that actually unfolded.

Mr. FOSSELLA. Well, I guess we're not going to make progress on that. But, let me just step aside, because I see my time is running now, and that is what is the position of the Department of Energy, other than waiting for these alternative fuel sources to come to fruition, what are your official positions, regarding the taxation on domestic oil producers, incentives, to encourage more production in the United States, as opposed to being dependent upon the foreign cartel and, also, the regulatory burdens that place disincentives on American oil producers, to—again, to bring that product to the table?

Mr. MAZUR. As part of Secretary Richardson's response to the low oil prices of last year—as you recall, about a year ago, the prices were $10, $11, $12 a barrel—he worked with the domestic producers, to try and find ways to reduce their costs of finding and producing oil. There were a number of technology programs to transfer technology to smaller independent producers, so they can get more out of the reservoirs that they have available. We've, also, worked for royalty relief on Federal lands. We have deep water royalty relief for some projects deep in the Gulf. And the Department is working on on-line oil and gas projects, to help get rid of some of the red tape, at least, in that area. So, we're doing what we think are measured responses to help domestic producers with their regulatory burdens.

Mr. BARTON. Unfortunately, the gentleman's time has expired and I've been reasonably strict with the other members. But, we are going to have, after Mrs. Wilson, kind of an open question period, so that all members, who are present, if you have one or two wrap-up questions for this panel. Congresswoman Wilson is recognized for 5 minutes.

Mrs. WILSON. Thank you, Mr. Chairman. I was interested in some of your testimony about allowing Secretary Richardson's energy diplomacy to work, and interested in it for a couple of reasons. This is—it's interesting to me that we're now pursuing this concept of diplomacy, which some commentaries within the last month have acknowledge that the administration was caught napping on energy policy. And I understand that now, as you've just testified, that the Secretary and the President have asked you to think creatively about alternatives and that everything is on the table, which raises a question of was everything on the table a year ago, when OPEC announced publicly that it was reducing its supply?

Mr. MAZUR. As you recall, OPEC announced several times they were reducing supply. There were a series of supply cuts. And as John pointed out a little bit earlier, that the effect of the cuts didn't really show up until, basically, the fall, in good measure. And so, we were monitoring the situation and looking at oil prices; but, frankly, a year ago, this committee was concerned about prices being too low and that was one of the areas that the Department was being tugged in.

Mrs. WILSON. When Secretary Richardson went to the oil—to the OPEC countries, diplomacy is usually a give and take game. What demands were made by OPEC on the United States?

Mr. MAZUR. I wasn't part of that trip, so I really can't—and I wasn't in the room with the Secretary, I really can't answer that.

Mrs. WILSON. So, we don't know what the price is?

Mr. MAZUR. Again, I wasn't there. Secretary Richardson would have to answer himself.

Mrs. WILSON. Who—you're the head of policy, right——

Mr. MAZUR. Yes, ma'am.

Mrs. WILSON. [continuing] in Department of Energy? Who is setting up what the policy is? Who is writing the talking points for the Secretary of Energy?

Mr. MAZUR. On international issues, we have the Office of International Affairs, that works on those, and the Secretary's office. There are a number of people, who have worked with him on this OPEC issue, and others, the energy diplomacy portion of things.

Mrs. WILSON. Mr. Chairman, I would very much like to ask that those folks come up here to testify, if we can't get answers about what America is giving up, in return for increased oil production. I think that really highlights the problem of foreign dependence pretty clearly.

Mr. BARTON. We're going to send written questions to the Secretary and this certainly will be one of the questions that we send.

Mrs. WILSON. A year ago, a section 232 investigation was initiated, with respect to oil imports and whether they are a threat to national security. Is that the most recent study done?

Mr. MAZUR. My understanding is that study is at the White House for review of the recommendations of the study.

Mrs. WILSON. What were its conclusions?

Mr. MAZUR. I don't know, ma'am.

Mr. BARTON. Excuse me, you don't know or you can't say, because it's still being cleared by the political officers at the White House?

Mr. MAZUR. It's being reviewed at the White House. The conclusions of the study, I did not work on that study, so I really don't know what the conclusions were.

Mr. BARTON. Well, I want to reenforce what the gentlelady from New Mexico is saying. I was a White House fellow at the Department of Energy in the early years of the Reagan administration and I worked in the Office of Policy, Planning, and Analysis. I mean, I was low man on the totem pole. I was way down there. But, the head of the Office of Policy, Planning, and Analysis knew what the policies were. How can you be a head of the policy office and with an apparently sincere and straight face claim you don't know? I mean, that—if you're honest—well, you're not under oath——

Mr. MAZUR. Yeah, I understand that.

Mr. BARTON. [continuing] but if you're being truthful, they must not include you in too many of the policy discussions.

Mr. MAZUR. I don't know how large the Office of Policy was when you were there. It is probably well below the size, at that point; much smaller operation, focused mostly on domestic issues, not international issues.

Mr. BARTON. All the more reason for you to know. If there are fewer bodies——

Mr. MAZUR. The section 232——

Mr. BARTON. [continuing] the body at the top would tend to be more informed on what the other bodies are doing.

Mr. MAZUR. The section 232 studies, there have been about a dozen—about 10 of them done in the past. Every single one has concluded that the level of oil imports has threatened national security. That sort of a finding in this study would not be surprising. The study then goes on to have a number of—studies tend to go on having a number of recommendations for what the Federal Government should be doing. That's the part that I just don't know what those recommendations are.

Mr. BARTON. We're going to give the gentlelady a little more time, because I've taken up some of your time. Would it be safe to say that you have been briefed, in your preparation for testimony, to tell us as little as possible?

Mr. MAZUR. No, that would be incorrect, sir.

Mr. BARTON. Okay.

Mrs. WILSON. Thank you, Mr. Chairman. How many barrels of oil per day does Iraq produce?

Mr. COOK. It's been fluctuating. Lately, we have estimated, February anyway, that it was around 2.3 million barrels a day.

Mrs. WILSON. And you expect, you hope, you, well, pray, I suppose, that OPEC will increase its production by a million barrels per day at the end of this month; is that right?

Mr. COOK. No, we assume that.

Mrs. WILSON. Even worse.

Mr. COOK. Well——

Mrs. WILSON. In May, the United Nations is, again, going to consider whether it will lift sanctions on Iraq. And every time that we come up to that decision point in the past, Iraq has sent a little shock into the oil market. Do you anticipate that, again?

Mr. COOK. I think based on their track record, you'd have to assume that there is always that potential for Iraq to disconnect, to disrupt, or suspend its shipments, when the various phases of the program roll over.

Mrs. WILSON. Mr. Mazur, what does this do our oil diplomacy?

Mr. MAZUR. Oh, as you can imagine, it complicates it quite a bit. When you have countries that we don't have very good relations with, Iran, Libya, Iraq, as part of the discussion, it's very much a complicating factor.

Mrs. WILSON. In fact, what it really means is that Saddam Hussein now holds the cards, doesn't it?

Mr. MAZUR. I don't think I'd go that far, no, ma'am.

Mrs. WILSON. He produces 2.2 billion barrels per day and OPEC may, if we're lucky, increase production a million barrels a day. And you don't think he's holding the cards?

Mr. COOK. It's 2.3 million.

Mr. MAZUR. Out of a world production of about 75 million, where other countries could, if they desired to, make up some of that excess. For instance, Saudi Arabia has excess capacity to more or less offset, if that were desirable.

Mrs. WILSON. I think what this gets to, Mr. Chairman, is just how vulnerably we are to dependence on foreign supply and just how weak how diplomatic approach is. Thank you, Mr. Chairman.

Mr. BARTON. I thank the gentlelady. We're going to set the clock at 10 minutes. This is going to be an open question period, so any congressman can ask a question. So, we got to this up in the next 10 minutes and then go to our second panel.

Mr. MARKEY. This is the fastest finger round, then, okay.

Mr. BARTON. This is do you want to be a millionaire, if you push the right button.

I'm going to start it and I want to ask our two witnesses from DOE and EIA, this model that you put on the board showed a projected retail gasoline price increase. My question: in the next coming months, we can't do a lot about what wasn't done 3 or 4 months ago, but we can do something about what we do the next month or 2. How much available refined product supply is there in the world and how rapidly do your models project it? If wholesale gasoline prices on U.S. markets stay where they are or go higher, then how much of that would be redirected from Europe or Asia, come into the United States, and how quickly would it get here? Do you understand the question?

Mr. COOK. Sort of. If the market gets very tight in the spring and summer and needs more imports, historically, there has been 400,000-500,000 barrel a day excess gasoline capacity in Europe and, typically, it would take 5 to 10 cents a gallon, in terms of higher New York Harbor prices, to attract that extra supply.

Mr. BARTON. Today on the New York market, unleaded gasoline wholesale dropped from 96 cents a gallon to 94.9 cents a gallon, so it's down about 2 cents a gallon. I don't have any clue where 94 cents a gallon relates to the European market. Where would the price have to be, at the wholesale level, landed in New York, for the available surplus capacity of unleaded gasoline to be redirected to the U.S. market?

Mr. COOK. Well, first of all, we get a base—a baseline line of imports from Latin America, the Caribbean, Canada, anyway, again, 5 to 10 cents higher in New York—New York Harbor, 5 to 10 cents higher than, say, Rotterdam is normally enough to at least redirect flows from those regions, incremental flows, and attract excess European gasoline. So, if, you know, New York Harbor is at 95 and Rotterdam is at 85, I would anticipate some beginnings of movement.

Mr. BARTON. Okay. I've got other questions, but, Mr. Wynn?

Mr. WYNN. Thank you, Mr. Chairman. Mr. Mazur, you were saying, when we were talking about an eastern reserve, that you did not like that approach and the administration was pursuing other approaches involving alternative fuels: methane, ethanol, natural gas, in substitute. The question I have is: given that the consumers homes are basically set up to operate on home heating oil fuel, if you will, how are you going to substitute these other fuels that use a different mechanism, if you will, to operate? I mean, are you going to retrofit homes? I mean, how are we going to actually make this substitution work?

Mr. MAZUR. Let's think about natural gas in the New England area. We're seeing a number of pipe—a couple of pipelines being built into New England, to power electric generating facilities. You could imagine that large industrial facilities could make use of that natural gas and get off of fuel oil, if that is economical for them to do so.

Mr. WYNN. What about the residential consumers?

Mr. MAZUR. New residential markets are—or new residential developments will be more likely to be gas than oil. It's much more difficult to convert existing residential developments.

Mr. WYNN. I'm going to—okay, that's where I wanted to go, because my time is short. Senior citizens, low income citizens in these areas that have severe weather are not likely to have newer homes that are suitable for these alternatives. So, what are they going to do?

Mr. MAZUR. To the extent you can take pressure off of fuel oil use by converting other sources, there should be greater amounts of fuel oil available for them, putting some downward pressure on prices.

Mr. WYNN. When—and this is my last question, Mr. Chairman—when is this conversion going to take place?

Mr. MAZUR. This is a long-term process. You can ask Mr. Markey how long it takes to put pipelines in New England. It takes a long time. It's a period of years.

Mr. WYNN. So, we're talking about a solution that is not going to be viable within, say, the next 5 to 7 years?

Mr. MAZUR. Certainly not next winter; maybe the 5 to 7 years——

Mr. BARTON. The last two pipelines built in New England for natural gas have come on line in the last year and they took 5 to 7 years to site and build, I'm told.

Mr. MAZUR. Okay.

Mr. BARTON. Let's go to Mr. Fossella and then we'll come back to Mr. Markey.

Mr. FOSSELLA. Again, Mr. Mazur, we talked before about what we can do to—or what the Federal Government and what this administration can do, to establish a long-term plan to decrease our reliance upon the cartel. Several years ago, the House and the Senate passed legislation that would have opened a tiny portion, 1⁄100 of 1 percent, the Arctic National Wildlife Refuge to oil exploration, and the administration vetoed it. And some of the members here today have raised it as a possibility, as a way to decrease our reliance. Do you believe that we should seek that as an alternative, as an option?

Mr. MAZUR. I think the administration's position is pretty clear on ANWR. I think that the opening of that would incur significant environment costs and that, at this point, the administration doesn't support that at all, no.

Mr. FOSSELLA. And that is your position, as well?

Mr. MAZUR. That's my position, as well, yes, sir.

Mr. FOSSELLA. Dr. Cook, you mentioned the OPEC, you're anticipating a million dollar—a million barrel increase at March 27 meeting—assuming a million. Isn't there indications that there's about a 3 million barrel per day demand right now? So, in light of that, will there still be a 2 million barrel per day demand, in addition to the 1 million barrel per day increase in production?

Mr. COOK. I'm not sure I followed you. What I think you're saying is that our assumed million barrel a day increase is maybe half as much as necessary to balance markets, according to other groups that do these forecasts. Our own estimate is that it would take 2 to 2.5 million barrels a day, as I testified earlier——

Mr. FOSSELLA. Right.

Mr. COOK. [continuing] to balance the market. So, that's on the low side. Bear in mind, that's our base case, which tends to be conservative, and it shows high prices. If OPEC actually does increase the 2 million, then that should go a long way to begin restoration of low inventories. Again, it's just, you know, a starting point.

Mr. FOSSELLA. I'm just curious, we've been there for these countries in the past and they risk losing their sovereignty. Doesn't it disturb anybody that we're just sort of hoping on a wing and a prayer that these countries may come forward and increase production? We don't look to destabilize their economy by any stretch, but there's a legitimate demand, whether you're in Maryland, in Massachusetts, or anywhere across the country. Doesn't anybody in this administration have a problem with that?

Mr. MAZUR. Part of what Secretary Richardson is doing, when he goes to meet with these leaders, is to remind them that we have a strong partnership with them and it covers a number of different dimensions, one of which is oil, but there are other dimensions, as well, and that he does make clear partnerships go both ways.

Mr. BARTON. Mr. Markey, you had another question?

Mr. MARKEY. Yes, I do, Mr. Chairman, thank you. I just wanted to say to the Department of Energy, you guys aren't giving yourself enough credit in anticipating this energy crisis. In fact, on October 6, 1999, the Department of Energy's, Energy Information Agency forecast for this coming winter fuel costs increases rising as much as 44 percent for household heating expenditures. The increases were attributed to the likelihood of a colder winter this year and dramatic increases in crude oil prices.

How do I know that? Because, you put out that report on October 6 and I wrote you a letter on October 7 and I got the entire Massachusetts delegation to sign on with me, saying, in light of what you've just said on October 6, we would suggest exploring the use of the strategic petroleum reserve, to ameliorate the sharp increases in home heating oil prices, should your forecast prove accurate. And, in addition, we requested that you ask the Department of Energy to examine the adequacy of current home heating oil inventories at refineries and storage tanks in the northeast, as well as other measures undertaken by the industry. So, I sent you this letter on October 7, based upon your public statements about what you were anticipating this winter.

So, you're down there saying how difficult it might have been to predict, I guess forgetting your own report and forgetting the letter I then sent you from the northeastern delegation asking for anticipatory action, based upon your own report. So, I'm just, again, continually dismayed by your attempts to, you know, leave us with the impression that you didn't know what was going to happen.

As I see it, we have a decision made by OPEC last year, to reduce the production by about 6 percent. That decision comes on the heels of a year, in which prices have been at historic lows and demand was depressed by the recession in Asia. So, oil companies are in a mind set all through last year, where they aren't inclined to add to their refined product inventories. You identify that in your report. So, I don't think it takes a Nobel prize in economics to recognize that prices were headed up by the fall and that these price spikes would be most sharply felt in the northeast, where families are most dependent on home heating oil. And now, we're facing the prospect that the same reduced supply in crude oil is likely to result in increased gas prices at the pump by the summer peak driving season. And what this reminds me of is that old verse, "for want of a nail, the shoe was lost; for want of a shoe, the horse was lost; for want of a horse, the battle was lost; for losing the battle, the kingdom was lost."

We now put our economy increasingly in jeopardy. The longer we ignore the ascertainable facts, which were there on October 6, that we had to take swifter, more forceful action with the oil companies domestically, to buildup their inventory; but, also, with these other countries, to let them know how seriously we were going to react to whatever action they took; and at the end of the day, not having taken those actions, to then take the deployment of the strategic petroleum reserve off the table is the ultimate cruel cut to those consumers in the northeast, because, at the least, they were left with a misimpression that that could be used as something that could deal with the unjustifiable non-market-based prices that were going to be inflicted upon them.

So, again, I think that you're sitting down here with a—you know, with this see nothing, know nothing attitude here today; but, it was clear to me in October, just last year, that you knew what was coming. You predicted what was coming. And my response to you was please do something in anticipation of those events unfolding. Thank you, Mr. Chairman, unless Mr. Cook wants to respond.

Mr. BARTON. If you want a quick response, because we've got our second panel and I want to get to that, but give you a chance to respond to Congressman Markey's, I thought, very well put comments. I have to say that the constituents of Massachusetts ought to be well served that he could reply that quickly on a report and be as on the mark as history has turned out that he was. I'm very impressed with that fact.

Mr. MARKEY. Thank you.

Mr. COOK. Mixed feelings about it. I think what I'm hearing is that EIA did signal enough for Mr. Markey, as early as October. On the other hand, the signal that we sent out in October was based on two things. When you said the weather would be colder, that assumed normal weather. We had the previous year in 1998 warm weather. So, that was what that reference was, that we would just have normal weather.

Mr. MARKEY. Was normal weather warm weather or cold weather, as you were predicting?

Mr. COOK. The previous year, the 1998-99 winter was much warmer than normal, so we were assuming a return to normal weather, which would add to heating demand. The second assumption there—nothing like what we saw in late January, mind you; just normal weather. The second assumption was that crude oil prices, underestimated, would rise as high as $24 to $25 a barrel. Based on those relatively low projections, we said the home heating oil costs would be up 44 percent.

The issue that I think we've been talking about today goes far beyond that. We did not project $1.96 for home heating oil—$2.12 for home heating oil. That's the part that we could not predict, because of the cold weather and the other factors that were in the Harbor. But the higher crude price, the normal weather, we did.

Mr. MARKEY. Mr. Cook—Dr. Cook, I don't think you understand. What you predicted was enough for me and our delegation to write to you, to say please now take action, because a 44 percent spike in the price of home heating oil is unacceptable, and you did nothing in anticipation——

Mr. COOK. No.

Mr. MARKEY. [continuing] of that.

Mr. COOK. What you have done is take EIA out of the debate and you have said that from your standpoint, that's a high enough price for the issue of the SPR to be on the table. I have no comment on that. It's not my role.

Mr. MARKEY. Yeah, my—I don't have a problem with you, Dr. Cook, by the way. My problem is with Mr. Mazur, okay. No response.

Mr. BARTON. We're going to have to——

Mr. MARKEY. You are Paul Revere, saying, you know, OPEC is coming, okay. Now, over here, Mr. Mazur, then, did nothing to ensure that the United States had some kind of response that was put in place. That's my problem.

Mr. BARTON. We need to continue this dialog at a later point. But, I do want to reinforce one thing that Congressman Markey said, I disagree with his solution, which is using the SPR, but I don't disagree with the fact that given all the indicators that were at the disposal of the policymakers at DOE and the White House, literally nothing was done. Now, that, to me, does merit some attention, because the Clinton Administration does have the responsibility for implementing policy decisions and there was adequate information to predict that a shortage was coming, that it was going to impact the northeast unduly. And I don't see that there was any action taken until December or January, and I think that's inexcusable.

I do want to thank this panel. We didn't ask Mr. Parker any questions, because we were told at the staff level that you couldn't answer too many questions, based on pending investigations. So don't feel like you're unloved; we just ceded to the staff request that you be able to talk in general terms. We will have written questions for this panel. We do excuse you. We thank you for your personal attendance today.

We now want to call our second panel forward and we have a number of members here that want to introduce personally some of the witnesses. I'll call the panel generally and then I'll yield to each member to introduce your specific witness.

We have Mr. Red Cavaney, who is the President and CEO of the American Petroleum Institute. We have Mr. Neal Wolkoff, who is the Executive Vice President, New York Mercantile Exchange. We have Mr. Samuel Farruggio, who is the President of Farruggio Express in Bristol, Pennsylvania, and he is representing the American Trucking Association. Mr. Mark Murphy, who is an independent producer from Roswell, New Mexico, he is here on behalf of the Independent Petroleum Association of America. Mr. Bob Slaughter, former staff member for this committee, who is here as general counsel and Director of Public Policy for the National Petrochemical and Refiners Association. And Mr. Peter D'Arco, who is the Vice President of S.J. Fuel Company, from Brooklyn, New York, and he's representing the Petroleum Marketers Association of America.

I'm going to yield to Mr. Greenwood to introduce more formerly Mr. Farruggio; then, Mrs. Wilson to introduce more formerly Mr. Murphy; and then Mr. Fossella to introduce more formerly Mr. D'Arco.

Mr. GREENWOOD. Thank you, Mr. Chairman. I want to thank you for holding this hearing. I want to, also, particularly thank you for responding to my request that Mr. Farruggio be able to come—my constituent be able to come here and testify.

Sam Farruggio is the President of Farruggio Express. His company operates out of Bristol, Pennsylvania, in my district. It's a family owned and operated business that was opened over 80 years ago by Mr. Farruggio's grandfather. Mr. Farruggio, who has worked in the trucking industry for 30 years, will be able to shed some light on how the diesel fuel price crisis has not only affected his business, but, also, that of other independent truckers—truck owners and small trucking companies and large fleet owners. I called Mr. Farruggio and asked him if he would be so kind as to come to Washington and testify. I did not warn him that he'd have to spend 4½ hours sitting, listening to others testify. But, I hope he found it edifying. I'm glad you're here.

I am in the midst of another hearing, another subcommittee, so I apologize that I can't stay. But, I did want to introduce my constituent and thank you for that indulgence, Mr. Chairman.

Mr. BARTON. Mrs. Wilson, and welcome, Mr. Farruggio, to the committee.

Mrs. WILSON. Thank you, Mr. Chairman. I'm real pleased to have Mark Murphy here from Roswell, New Mexico, which is outside my district, so I have no aliens in my district.

We are very pleased that Mark is with us here today. He's the President of Strata Production Company, an independent oil and gas exploration and production company. And as most folks in this room know, the independent producers in the continental United States are the ones, who are producing most of the oil. They are kind of the wild catters and I'm real pleased. I can't see real clearly, but Mark is usually in cowboy boots and we love him for it.

Mr. Murphy has served as the Chairman of the United States Department of Interior Public Lands Advisory Council, as President of the Independent Petroleum Association in New Mexico, and a member of the U.S. Department of Energy, Secretary of the Energy Advisory Board. He has served on the task force on alternative futures for the Department of Energy, National Laboratories, which was known more widely as the Galvin Commission, and on the task force on Strategic Energy, Research, and Development. He is a member of the National Petroleum Council and currently serves as the Chairman of the Lands and Royalty Committee of the Independent Petroleum Association of America. And we're real glad to have him here.

Mr. BARTON. Welcome. And let the record show he does not have cowboy boots on.

Mrs. WILSON. I'm really disappointed in you, Mark.

Mr. BARTON. It looked to me like they're loafers.

Mr. MURPHY. My wife wouldn't let me bring them.

Mr. BARTON. Mr. Fossella, would you like to introduce your witness to the committee?

Mr. FOSSELLA. Thank you, Mr. Chairman, and welcome the panel. I'd like to introduce Mr. Peter D'Arco from Brooklyn, New York. He's Vice President and Chief Operating Officer of S.J. Fuels, a third generation company that has about 5,000 clients in the New York City area. And we met several weeks ago on Staten Island, to discuss the impact. Again, this lack of action, as we've highlighted here today, the impact on men and women across Staten Island and Brooklyn, the high home heating costs, and we prayed for warm weather and it seems we got it. So, that solves one problem, but we have others that come down the road. So, I want to thank you for your patience today and thank you for coming down.

Mr. BARTON. Thank you, Congressman Fossella, and welcome, Mr. D'Arco. And for you other gentlemen, who didn't have members to personally introduce you, we love you, too, and suffice it to say that the minority and the majority staff work together in a bipartisan basis, to make sure that this panel was a very balanced panel.

We're going to start with Mr. Cavaney, who is representing the American Petroleum Institute. We will give each of you 5 minutes to summarize your written testimony, which is in the record in its entirety, then there will be a question period. So, Mr. Cavaney, welcome to the committee.

STATEMENTS OF RED CAVANEY, PRESIDENT AND CEO, AMERICAN PETROLEUM INSTITUTE; MARK B. MURPHY, STRATA PRODUCTION COMPANY; NEAL WOLKOFF, EXECUTIVE VICE PRESIDENT, NEW YORK MERCANTILE EXCHANGE; BOB SLAUGHTER, GENERAL COUNSEL AND DIRECTOR OF PUBLIC POLICY, NATIONAL PETROCHEMICAL AND REFINERS ASSOCIATION; SAMUEL FARRUGGIO, PRESIDENT, FARRUGGIO EXPRESS; AND PETER D'ARCO, VICE PRESIDENT, S.J. FUEL COMPANY

Mr. CAVANEY. Thank you, Mr. Chairman and members of the subcommittee. My name is Red Cavaney. I am President and CEO of the American Petroleum Institute. I appreciate the opportunity to offer our assessment on the recent oil supply situation and on the impact of rising petroleum product prices on consumers.

America's oil and natural gas companies have a proud history of providing this country's consumers with a reliable and affordable supply of energy, that gives Americans the mobility they need and the products that make their homes comfortable and their lives more enjoyable. It is because of this history of service that we understand the impact of rising prices on the Nation's consumers. We find no comfort in knowing that a number of them might be facing hardships or inconveniences. We share your concerns for the health and welfare of your constituents. They are, also, our customers and our neighbors.

Research has shown that Americans know how the markets work. They understand that with America importing some 55 percent of its crude oil, we are significantly impacted by outside forces, whether it is OPEC or other producing nations. We, also, know that Americans believe our member companies are doing a good job, given this country's heavy dependence on foreign oil, the unwillingness of our government to allow these companies to more fully explore for oil and natural gas on Federal lands and the noncoordinated layers of regulation that limit refiners ability to keep the fuel flowing into America's cars, homes, and manufacturing plants. Over regulation reduces the flexibility refiners need to respond to this fast pace changed world.

America's consumers are frustrated over their sense that control of something very crucial to their lives has moved to forces over which they have very little influence. We understand that frustration. A stronger, more vibrant domestic oil and natural gas industry can provide Americans a better sense of security about their energy needs.

Price increases arising from international market conditions have imposed hardships on consumers, particularly those on fixed incomes, farmers, and truckers. But the American people understand that these increases were brought about by short-term shocks that resulted from sudden changes in supply and demand. Prices are up now, but they will go down when factors change. In a free market economy, we've seen time and again that price movements ultimately create balance between supply and demand. If allowed to work, the marketplace delivers lower average prices over time to consumers.

Government industry can work closer together, to ease some of the hardships and concerns faced by American consumers. We are urging the Energy Information Administration to convene a summer fuels conference, to evaluate the status of gasoline, diesel, and jet fuel production and inventories. We are, also, asking EIA to expand the scope of their winter fuels conference, to give the agency the opportunity to share information on winter fuel production inventories and imports with all of the stakeholders.

The government can, also, take steps to further inform consumers on energy market conditions. API has participated in the Department of Energy's meetings on heating oil conditions and stands ready to provide information on market conditions. We will seek to develop a joint effort with DOE, to provide consumers the best and most updated information available and to help them find ways to better cope with the fluctuation in prices.

The government should, also, take steps to help further prevent the reoccurrence of the home heating oil situation. It can increase funding for the low income housing energy assistance program and move quickly and equitably to release funds, and they can consider expanding SBA emergency loans to home heating oil dealers and to truckers. Secretary Richardson's leadership here, as this unfolded, has been very helpful.

Government, however, should, also, take long-term steps, to strengthen our domestic oil and natural gas industry. We can reduce our reliance on foreign supplies and, also, exert downward pressure on international crude oil prices, by opening our best oil and natural gas prospects to responsible exploration and development, many of these areas which have been placed off limits by the Federal Government. Since 1983, access to Federal lands in the western United States, where nearly 67 percent of our on-shore oil reserves and 40 percent of our natural gas reserves are located, have declined by 60 percent.

Mr. Chairman, we know that Americans have learned to rely on America's oil and natural gas companies. We, also, know that they want the facts about the current situation and what it can mean for the future, especially as they face the upcoming vacation season. That trust calls for honest answers and the only honest answer we can offer today is that things may get a bit tougher before they get better, but they definitely will get better.

Because of the international market supply and demand situation, we cannot always guarantee gasoline, diesel, and home heating oil at prices Americans would prefer to pay. But, we can guarantee that our companies will do all they can to keep fuel available and to keep this country going strong. Thank you, Mr. Chairman.

[The prepared statement of Red Cavaney follows:]

PREPARED STATEMENT OF RED CAVANEY, PRESIDENT AND CEO, AMERICAN PETROLEUM INSTITUTE

The American Petroleum Institute (API) is pleased to have the opportunity to present a statement on the recent oil supply situation in the United States, and on the impact of rising prices on consumers of petroleum products. API represents almost 500 companies engaged in all aspects of the U.S. oil and natural gas industry, including exploration, production, refining, distribution and marketing.

Our industry works very hard to provide consumers with the energy they need for their daily lives. Therefore, we can appreciate your concern about the current oil supply situation, and your desire to lessen its impact on your constituents. I want to assure you that we in the industry are likewise concerned. We appreciate this forum to share with you our views about the causes of the current situation. We are taking what actions we can to improve conditions, and also have suggestions to offer for actions that can be taken by government and even by consumers, themselves, to help through these difficult times.

First, let me take a moment to frame the situation. While research and development continue on alternative sources of energy, gasoline and diesel fuel remain the most cost-effective and prevalent fuels for our transportation needs. To be specific, 97 percent of all transportation is fueled by petroleum products. These fuels, and the infrastructure built to fuel a nation of cars and trucks, allow us to get us where we need to go. Whether we need to go to work, take a school bus, get produce to market, or fly for business or pleasure, oil plays a crucial role in our daily lives.

But for decades, as a matter of government policy this nation has reduced the industry's access to some of the most promising domestic resource areas for oil and gas exploration and development. As a result, despite significant energy efficiency gains since the 1970s, we have become increasingly reliant on foreign supplies of crude oil.

As the markets rise and dip, American consumers sometimes benefit, as was the case last year when prices were at historic lows, and sometimes suffer when prices are high, as they are now. The industry is keenly aware of the fact that rapidly rising prices cause consumers to pay more for their needs than they had budgeted. This means less is available in the family budget for other equally pressing needs. People aren't as able to take care of their families as comfortably. This is a concern to us, as well, and we understand that consumers expect us to do everything in our power to help alleviate these conditions. We want to help.

I would now like to explain our perspective on the current situation.

Just last year at this time, we were experiencing some of the lowest prices—adjusted for inflation—for petroleum products in this century. Crude oil was selling for less than $13 per barrel and gasoline prices were less than $1 a gallon. Things have certainly changed. Today, crude oil is in the $34 range—a 160 percent increase.

What caused these changes?

The simple answer is supply and demand. Worldwide crude oil supplies have declined, as major, foreign crude oil exporters have reduced production. These declines, in combination with increased worldwide demand for crude oil from growing economies, have driven world oil prices sharply higher.

Because crude oil is the largest cost component of gasoline, heating oil and diesel fuel, prices of these fuels have also increased. Gasoline, heating oil and diesel prices have increased by about 60 percent.

It is during times of uncertainty, such as concerns over fuel prices, that we hear the louder voices of those who demand that government step in to offer immediate relief. Such actions always involve consequences, and it is important that all concerned understand the full range of the potential consequences from any such government involvement. All voices should be heard, of course, but these voices should be listened to in context. In this case, for instance, we should not lose sight of the fact that this situation is not new: prices have risen before. Such increases are the result of complicated market forces that operate globally as well as locally.

In addition, we should remember that the overall economic prosperity we are now experiencing is partly due to the efforts of moving government out of is direct involvement in major sectors of the economy—deregulation. The United States is the envy of the world because of its productivity and efficiency.

This is not, however, to say that the particular confluence of events that occurred in recent weeks was not extraordinary. What it does mean is that the world market, as well as local supply-and-demand conditions, will occasionally create price spikes. However, as history has shown, these variations are soon returned to a "norm" by the market, when it balances supply and demand. We cannot, however, lose sight of the fact that these price shocks have potentially dire consequences for low- and fixed-income consumers, and action must be taken to help these consumers.

Supply, demand and price

The price of crude oil, obviously, is the dominant influence on the price of all petroleum products. For example, crude oil currently accounts for approximately 50 percent of the cost of gasoline. The current price of crude is about $34 per barrel. A year ago, the price was about $13. That's a jump of about 160 percent.

OPEC has been a critical factor. While many market watchers may have believed OPEC's ability to move world markets was diminished, what we have witnessed since March of last year would belie that notion. OPEC and several non-OPEC producers such as Mexico and Norway have removed significant amounts of crude oil from production. Coupled with the new increasing world demand for petroleum, especially in the Far East, this production rollback is having a significant impact on supply, pushing prices higher.

In the case of heating oil, the increase in demand was local. Extremely cold weather in the Northeast increased demand for home heating oil and forced natural gas suppliers to curtail or eliminate deliveries of natural gas to "interruptible" customers. "Interruptible" natural gas customers usually pay lower prices for gas on the condition that they can be interrupted, if their suppliers need their gas for other customers such as residential users. When the interruptibles' natural gas was redirected to other customers, these interruptibles switched to other petroleum products to meet their needs, further squeezing an already demand-heavy market.

It's important to remember, too, that extreme temperatures had a temporary impact on supply and price by increasing transportation and delivery disruptions. For example, because there are no pipelines for petroleum products into New England, products must be barged from New Jersey. However, frozen rivers slowed or stopped barge traffic in many locations in the Northeast. As a result, supplies at some northern terminals were severely reduced. At times, roads were not much better. In our nation as a whole, almost 75 percent of petroleum products travel by pipeline. Consequently, the New England region is much more vulnerable to weather impacts and fuel disruptions than elsewhere.

U.S. refiners are now implementing their driving season plans. Refineries are turning to increases in production for gasoline to meet the summer driving demands, since inventory must be built in advance of use. We have reviewed production, imports, inventory and refinery utilization statistics and believe we will be able to meet the needs of our customers this summer.

However, the entire petroleum-products distribution system is stretched to its limits and its flexibility has been significantly reduced. We are wrestling with significant hurdles in the form of increasing non-coordinated government regulatory constraints on refinery operations. These regulations deal with gasoline sulfur, reformulated gasoline, new-source review, MTBE and diesel sulfur, to list a few.

The price of gasoline is, of course, influenced by world crude oil prices—and today this country imports about 55 percent of its crude oil. If recent reports of increased supplies by foreign national producers turn out to be true, the increased supply will be a welcome addition.

Inventories

Some media reports have created the impression that U.S. suppliers have pinched supply in order to drive up price. Statistics do not support such claims. For example, inventories for heating oil were low earlier as a result of two and a half years of moderate weather, coupled with the high cost of maintaining excess stocks. In fact, in response to the 1999-2000 cold snap in the Northeast, the industry was able to supply 17 million barrels of distillate (home heating oil) from inventory over a three-week period—the largest amount of distribution for a three-week period in five years. In total, nationwide inventories were adequate. Because of the weather-related conditions and uniqueness of the New England fuel logistics, getting inventory into that market took time. As mentioned earlier, the cold weather slowed or stopped the delivery of supplies in New England. Prices then rose dramatically because of local bidding for scarce supplies. However, to the best of our knowledge, no one went without heating oil.

Occasionally, consumers suggest that refiners should increase inventories to better protect them against possible price spikes. While refiners make their own decisions about inventory levels, and other business matters, if they had increased inventories to last year's levels, it would likely have been at greater cost to the consumer than any savings relief they might have realized during the cold snap. Increased purchases of crude oil would have no doubt driven world crude oil prices even higher. Thus, increased inventories would not have protected consumers from higher fuel prices. Increased production, increased inventory and additional storage are all increased cost factors.

Inventories kept available by primary suppliers and retail marketers are not regulated. However, suppliers who fail to estimate correctly the inventories they will need to satisfy their customers pay a stiff penalty in a competitive market. If inventories are too low, the suppliers lose customers to their competitors. And some of those customers may well never return. If inventories are too high, the suppliers bear higher costs and necessarily charge higher prices than their competitors, eventually losing customers and risking their entire business.

Similarly, there have been some recent predictions about gasoline prices based on low inventories of gasoline. Inventories for gasoline are currently lower than normal, but they are not currently at a problematical level, based on estimates from the National Petroleum Council. The NPC estimated in 1998 that about 185 million barrels of gasoline inventories were needed to keep the nationwide distribution system running smoothly. Current inventories are about 200 million barrels.

Production

Some have alleged that refineries have restricted output. The facts are at odds with this contention. Production of distillate fuel oil this heating season has been higher than average and may actually set a seasonal record. While refinery utilization is lower than last year and lower than normal, the most relevant and important measure is actual production—and gasoline production has also been high. Gasoline output for 1999 was 8 percent higher than average. Gasoline production has averaged the highest ever over the past six months. February's gasoline production figure of 7.76 million barrels per day was the most ever produced in a February.

Refinery management cannot and should not automatically increase production in response to calls for increased output. Each refiner's situation is unique and must be looked at by those in positions of responsibility in those organizations. Refineries are complex structures operating under high temperatures and pressures. To push production beyond design limits may endanger the health and safety of our employees and the communities in which they operate. Already, there are ample incentives to increase output within safety tolerances.

Prices

Despite some recent upswings in price, today's retail heating oil and gasoline prices have increased by less than the jump in worldwide crude prices. According to the U.S. Energy Information Administration, heating oil retail prices peaked at a national average of $1.86 per gallon. They have fallen by about 40 cents per gallon since then. At this time last year, the average retail price was 86 cents per gallon, with crude prices about $13 per barrel. Gasoline prices have increased from about 92 cents per gallon a year ago to about $1.50 today. That's an increase of 63 percent compared to crude price increases of 140 percent. It would appear that retail prices not only have a direct relationship to the spiraling worldwide price of crude, but have been more restrained in their upward momentum.

What government can do

We are urging the Energy Information Administration to convene a "Summer Fuels Conference" to evaluate the status of gasoline, diesel and jet fuel production and inventories. We are also asking that the EIA expand the scope of the "Winter Fuels Conference" next fall to give the agency the opportunity to share information on winter fuel production, inventories and imports with all stakeholders.

The government can also take steps to further inform consumers on energy market conditions. API has participated in the Department of Energy's meetings on heating oil conditions and stands ready to provide information on market conditions. Educated consumers are our best assets. We will seek to develop a joint effort with DOE to provide consumers the best and most up-to-date information available, and to help them find ways to better cope with the fluctuation in prices.

In the short term, the government can also consider a number of actions to help prevent another recurrence of the home-heating oil situation. It can increase funding for the Low-Income Home Energy Assistance Program and more quickly and equitably release funds; and consider expanding Small Business Administration emergency loans to home heating oil dealers and truckers.

We think it's imperative that Congress quickly reauthorize the Energy Policy and Conservation Act that provides authorization for the Strategic Petroleum Reserve and U.S. participation in the International Energy Agency.

In the long run, government can and should also take steps to strengthen our domestic oil and natural gas industry. Popular belief to the contrary, the age of the American oil and natural gas producing industry is not over. It is very much alive, and can be an even more important asset if government were to take immediate steps to improve access to domestic oil and natural gas resources.

We can reduce our reliance on foreign supplies and also potentially exert downward pressure on international crude oil prices by opening our best oil and natural gas prospects to responsible exploration and development. Currently, many of these areas have been placed off-limits by the federal government. Since 1983, access to federal lands in the western United States—where nearly 67 percent of our onshore oil reserves and 40 percent of our natural gas reserves are located—has declined by

60 percent. Our industry works hard to supply the energy to keep America going strong, but to continue to produce domestic oil and natural gas, we must have access to federal and state lands.

The federal government has imposed layer upon layer of regulations on U.S. refineries without sufficient regard as to how these regulations impact refiners' ability to meet the full range of needs of the American consumers. Refineries need flexibility to respond to the fast-paced change in today's world. Overregulation reduces flexibility. A soon-to-be proposed regulation to drastically lower the sulfur content of diesel fuel is an example of a government action that could have negative consequences on our ability to supply heating oil and diesel fuel. We share the government's interest in cleaning the air. But reductions beyond the 90-percent level we proposed stand a good chance of further driving up fuel manufacturing costs unnecessarily, imposing yet additional burdens on our nation's truckers and farmers.

Even with greater access and flexibility, the United States will continue to need to rely on foreign oil supplies. Thus, it is important that we maximize the diversity of those supplies to help ensure the reliability of a continuous flow of oil imports. Unfortunately, U.S. unilateral trade sanctions narrow our sources of supply, frustrating achievement of this important objective.

In recent years, unilateral economic sanctions have increasingly become the policy tool of choice in the conduct of U.S. foreign policy. One of the favorite targets of these recent sanctions has been major oil-producing countries. The U.S. currently has sanctions in place against countries comprising over 10 percent of world oil production and 16 percent of estimated remaining oil resources. With little evidence that unilateral sanctions produce desired outcomes, is there not a better way?

In short, U.S. policymakers face a dilemma. Growing supplies of crude oil will be required to sustain world economic prosperity, and diverse, ample foreign supplies are needed to help ensure our own country's economic growth. The drive to impose unilateral sanctions is an obstacle to both of these objectives.

What Consumers Can Do

While it may be easier to see what government policymakers and the industry can do to improve the current situation, many consumers can help lessen the impact on their budgets by embracing ways to use less fuel. The industry will be doing its part to share advice for conserving fuel use in the hope that some families can benefit.

Examples of the types of changes drivers can make include: maintaining their vehicles properly, combining trips to reduce fuel consumption from cold starts of automobiles; accelerating slowly and decelerating rather than multiple braking to stop; and, in a two-car family, having the family member who does the most driving use the most fuel-efficient car. Many families will be surprised at the fuel economy benefits they can achieve from these simple changes. While they certainly won't offset the higher cost of gasoline, they should help families get where they need to go at less cost until purchasing conditions improve.

Conclusion

In closing, we share your concerns for the health and welfare of your constituents. They are our customers. They are our neighbors. We are as frustrated as they are by the sense that too many outside factors control our destiny. We believe that a stronger, more vibrant domestic oil and natural gas industry can provide Americans a better sense of security about their energy needs.

Price increases—brought about for whatever reason—have imposed hardships on consumers, particularly those with lower or fixed incomes. But these increases were brought on by short-term shocks that resulted from sudden changes in supply and demand. Just as prices are up now, they will turn down when factors change. In a free-market economy, we have seen time and again that price movements ultimately create balance between supply and demand. We are confident that if we continue to allow the marketplace to work, this balance will be maintained. And, history would show us that the longer-term cost of the product is less than would otherwise be the case.

America's oil and natural gas companies have a long and proud history of providing this country's consumers with a reliable and affordable supply of energy to make their homes comfortable and take them where they need to go, when they want to go. Through good and lean years, U.S. suppliers of petroleum products have kept America's factories running and provided the fuel to move goods from manufacturers to retailer and, ultimately, into America's homes and offices.

It is because of this history of service that we understand the impact of rising prices on this nation's consumers—our customers. We find no comfort in knowing that a number of them might be facing hardships or inconveniences. We are cognizant, too, of the concerns of our nation's truckers and farmers, who also have been adversely affected by these increases in fuel prices.

Finally, we recognize that you are faced with increasing demands to address this situation. To the extent to which we can help in your efforts to better understand the possible effects of the many various proposed actions under consideration, we are here to assist you.

Mr. BARTON. Thank you, Mr. Cavaney. We now would like to hear from Mr. Murphy for 5 minutes, please.

STATEMENT OF MARK B. MURPHY

Mr. MURPHY. Thank you, Mr. Chairman. My name is Mark Murphy. I'm President of Strata Production Company, an independent oil and gas exploration and production company, based in Roswell, New Mexico. Today, I'm representing the Independent Petroleum Association of America and the National Stripper Well Association. These organizations represent the backbone of the United States domestic oil and gas industry.

Mr. BARTON. Would you put on the record the definition of a stripper well, so that people don't think this is some sort of adult-oriented hearing.

Mr. MURPHY. Yes, sir. I believe that the current definition is 15 barrels per day or less. The independent producer is the true strategic petroleum reserve, in my opinion. We've got a 350 billion barrel reserve base in this country. And if you look to the independents to develop it, we need four things, and they all come under the heading of access, and its access to land, access to capital, access to technology, and access to skilled workers.

Now, thinking about that as a chair, a platform, you've got four important legs to it and there's probably a couple of cross beams there, one is regulatory reform and incentive programs. It's always difficult to follow someone as well prepared as Red; so, I'm not going to repeat all that he has said, but I'm going to try and hit a few highlights.

We understand and sympathize with the pain that people are going through due to high energy prices. Within the last 2 years, I've laid off half of my workforce and so I understand what that means, putting people out of work. It's difficult when you see companies and people that you've known for decades, companies that have gone from grandparents, to parents, to sons and daughters, close their doors.

There was an interesting question earlier in the hearing and it had to do with why prices are so high. And one thing that has struck me is, is that crude oil is 50 cents per gallon when oil is $21 a barrel. At $30 a barrel, it is 71 cents, so there's about 21 cents there. And, yet, we have seen prices rise by as much as 80 cents to $1.

If I recall the gentleman's testimony from the Department of Energy, he said that those things were related, as long as all things are equal. I think that was the testimony. So, there must be other factors, factors such as storage and transportation and those sorts of things. And I think it's important for people to keep that in mind, that it's not just the price, it's getting the product to where it needs to be.

Mr. BARTON. It's not the raw material price, that's what you mean?

Mr. MURPHY. Yes, sir, that's correct.

Mr. BARTON. It's not the crude oil price?

Mr. MURPHY. That's right. There were some other discussion, and this is something that has troubled many of us, and this is regards to section 232 analysis. Many in our industry called for that about a year ago; many in this Congress supported it. The administration has started it. We don't have an answer.

There was a similar analysis in 1993 and it concluded that imports at this level, 55 percent or so, are a threat to national security; yet, nothing has happened. There has been no major policy changes by this administration in that period of time, almost 7 years. We have heard about the 10,000 steelworkers that were put out of work. We haven't heard about the 65,000 oil and gas producers put out of work in the last 18 months. Since the 1980's, that number is about 500,000. That's a lot of jobs to lose and not have apparently anyone too concerned about it, certainly anyone in the administration. Prior to the 1986 crash, there were over 10,000 companies just like mine. There's about 6,000 now.

This consistent lack of interest hurts our industry and our Nation and it's got to be reversed. Now, this year, prices have returned to about the 1997 level. Had they stayed at the 1998-99 level for another year or 2, I would submit to you that we would have no industry left. So when people look at prices now and say, well, gee, they're a whole lot higher than they were last year and the year before, they're right; but if they had stayed at the 1998 and 1999 levels in a year or 2, there wouldn't be companies like mine.

We import over 55 percent of our crude oil.

Mr. BARTON. I hate to hurry you along, but we've got four more witnesses. So—and if you could kind——

Mr. MURPHY. Let me——

Mr. BARTON. [continuing] of summarize the next minute or so.

Mr. MURPHY. You bet, I sure can.

Mr. BARTON. And God knows, I would love to let you talk all afternoon, but we need to get the other testimony on the record. I think New Mexico is a lot like Texas, it's hard to say hello and my name in 5 minutes.

Mr. MURPHY. The National Petroleum Council has put out a report called the National Gas Report and it goes into many of the issues that I've talked about and I would encourage you to become familiar with that report. It talks about the access issues that I mentioned in the very beginning of my testimony, and access to land is absolutely critical; access to capital is absolutely critical; and much of that can be achieved through simple tax reform.

We would encourage this committee and those that are interested to spur the administration along, in concluding the section 232 analysis. And I guess the real disconnect that I see in the policy and one of the things that troubles me the most is, is that we have continued to hear about how the country must rely in the future on natural gas, and we agree with that and I think we can get out there and find it and develop it for this Nation. But the problem is, is we continue to see policies that discourage that very thing, access to less land and access to the other things that I mentioned. Thank you, very much.

[The prepared statement of Mark Murphy follows:]

PREPARED STATEMENT OF MARK MURPHY ON BEHALF OF THE INDEPENDENT PETROLEUM ASSOCIATION OF AMERICA

Mr. Chairman, members of the committee, I am Mark Murphy, President of Strata Production Company, representing the Independent Petroleum Association of America and the National Stripper Well Association. IPAA represents the 7,000 independent oil and natural gas producers that drill 85 percent of domestic oil and natural gas wells and produce approximately 40 percent of domestic oil and 66 percent of domestic natural gas. We are the segment of the industry that is damaged the most by the lack of a domestic energy policy that recognizes the importance of our own national resources.

Let me say at the outset that we understand the pain that high energy prices can cause, and we sympathize with those who have been shocked by sudden price increases in heating oil and diesel fuel. But it is equally important to understand that a year ago we were watching friends in the oil patch we had known for decades being driven out of business, companies that had been handed down from grandfather to father to son closing their doors forever. Neither situation is acceptable. Dramatic price shifts harm everyone. We need to look for routes to stability for both producers and consumers.

There is another fact that is frequently lost in the debate over high heating oil or diesel prices. Crude oil costs 50 cents per gallon when it is $21 per barrel. At $30 per barrel, it costs about 71 cents per gallon. So, when heating oil or diesel prices soar by $1.00 per gallon in a week, the source of the problem is not the crude oil.

Last month, it was reported that Energy Secretary Bill Richardson said that the Administration was caught napping at the start of the current heating oil crunch in the Northeast. Well if that's true, the Administration must have been hibernating during the 18 months that oil prices dropped to historic lows in 1998 and 1999.

Almost a year ago, the Administration started an analysis under Section 232 of the U.S. Trade Expansion Act to determine whether oil imports pose a national security threat. It has yet to be completed.

For the past two years we have heard President Clinton speak repeatedly about his concern for the jobs of 10,000 American steelworkers that were lost due to foreign competition. We have heard nothing about the 65,000 American jobs lost due to low oil prices.

We met with representatives of the president when oil prices were at their depth. We asked that the president state clearly that he understands the value of domestic oil and natural gas production and the importance of maintaining and enhancing it. They are words he has never spoken. This year, as 1997 prices have returned, we now hear voices of complaint. Recently, President Clinton was quoted as saying that he believed oil prices were too high and that it would be in the best interests of OPEC countries to lower prices. It is position echoed by many in Congress.

It is this consistent lack of interest in domestic oil and natural gas production that hurts the nation the most. Few in Washington seem to understand that today's problems result from prior decisions by our Government.

Let's review the critical facts facing us today.

One. it is wrong to compare today's crude prices to 1998 and 1999. Those prices were at historic low levels. 1997 is a more appropriate comparison.

Over the past two years the United States lived with unusually low crude oil prices. At the depth of the crude oil price crisis, crude oil was selling at prices—on an adjusted basis—not seen since the Great Depression. These prices were crippling the domestic oil and natural gas exploration and production industry. Over the eighteen-month time frame of low prices, the industry lost 65,000 American jobs. Even after months of higher prices, only about 7,000 of these have been recovered. Eighteen months of low oil prices resulted in devastating reductions in capital investment in the industry both domestically and worldwide. The consequences of this lost investment will take years to measure as existing wells were shut down prematurely and delays in bringing new wells into operation will no doubt limit the potential ability to meet expanding demand. The implications of those Depression-era prices are not just domestic. The lost investment extended to all producer countries.

Thus, if we are to realistically compare today's prices against a past price, we should look to 1997 before the oil price crisis began. Then, the economy was booming as it is now—oil prices were not a constraint.

Two, we now import over 55 percent of our crude oil demand. Like it or not, this is a national security issue. Our economy could well be defined by the decisions of Saddam Hussein in the near future.

There is pending an analysis under Section 232 of the U.S. Trade Expansion Act to determine whether the current level of oil imports presents a threat to national security. This assessment has been made five times before. In each instance the analysis concluded that a threat exists. However, perhaps now more than ever, the threat is as imposing as it was in 1973 when the Arab Oil Embargo crippled the American and European economies. While that crippling effect required the concerted effort of many Arab countries, today, it could accomplished by just one country—Iraq. Why?

Clearly, Iraq's actions are driven by its own political agenda. As it was prior to the Persian Gulf War, Saddam Hussein's objective is to dominate the Middle East. What he could not achieve militarily in 1990, he now seeks to achieve through the manipulation of other countries. Today, he seeks to rid himself of the UN sanctions, to gain the ability to control his nation's oil resources and spend that wealth how he chooses. He uses the failed UN humanitarian aid process to gain worldwide sympathy for the Iraqi children he prevents from receiving food and medicine that has been purchased for them. He uses the greed of France and Russia and China to restore and improve Iraq's oil fields to weaken UN Security Council resolve. He uses radical Moslems to try to destabilize his Arab neighbors' governments. He will use an oil weapon as soon as it becomes available.

When will that be? How about two months from now.

Today, the world uses about 77 million barrels per day of oil. The oil price crisis of 1998-99 essentially resulted in a lost year of capital investment in maintaining existing oil production and developing new production. As a result the world's excess oil production capacity has diminished. Most of it is controlled by Saudi Arabia, which has long been considered the world's swing producer of crude oil. Estimates of this capacity vary.

Now, OPEC is grappling with increasing its production to accommodate world demand and reaction to higher prices. But, it is walking a dangerous path. OPEC speaks of raising production by 1 million barrels per day beginning in April. Most oil industry analysts argue that the increase needs to be about 2.5 million barrels per day. Some OPEC members argue that no Increase is needed now because of traditional demand drops in the second quarter of the year. In reality, many experts question whether all OPEC countries could increase their production consistent with their current quotas. On March 6, both the *Financial Times* and the *Wall Street Journal* ran articles about OPEC capacity. The *Financial Times* questioned Venezuela's production capacity. The *Wall Street Journal* analyzed both Iran and Iraq. The conclusions were similar—the capacity is not there.

So, while it may be possible to increase production by 1 million barrels per day, a 2.5 million barrels per day increase may exceed current capacity—or can only be provided by Saudi Arabia. No one knows for certain. Either case plays into the hands of Saddam Hussein. Iraq currently exports about 2 million barrels per day, sometimes more. In May, the UN again reviews its sanctions policy on Iraq. In the past, Saddam has temporarily withdrawn production to tweak the world markets. But this time he will be in a unique position. This time, if he pulls his oil off the market, the market will be short. This time, it will cause substantial price spikes, perhaps to $50 per barrel. This time, other production cannot be instantly increased and the world will have to grapple with Saddam's demands to remove UN sanctions and then—maybe—he will return to the oil market.

We hear many argue that we should release oil now from our Strategic Petroleum Reserve. We should not. It is there to respond to supply shortages, particularly politically created supply shortages. If we act now to use the SPR when the issue is price, it won't be available when the true crisis comes.

Three, in 1986 we produced 8.5 million barrels/day of domestic oil; now, production has dropped to below 6 million barrels/day.

Prior to the last oil price crisis in 1986, domestic oil production was about 8.5 million barrels per day. By 1997, domestic production had dropped to about 6.5 million barrels per day—a 2 million barrel per day loss. In 1998, the Clinton Administration's energy strategy called for a 500,000 barrel per day increase in domestic oil production by 2005—moving to a 7 million barrel per day target. Now, as a result of the 1998-99 price crisis, domestic production has dropped below 6 million barrels per day.

Four, this drop in oil production reflects changes in investment in the United States—a change largely due to the 1986 price crisis as major oil companies shifted their investments out of the U.S. lower 48 states onshore.

The 1986 oil price crisis demonstrated that the United States was the world's highest cost production area. In particular, the lower 48 states onshore is the highest cost area because it is such a mature area compared to the rest of the world. Combined with domestic policy changes, like the 1986 tax reform law that created the Alternative Minimum Tax, the desirability of domestic oil development in the lower 48 states onshore dropped dramatically. As a result, the major integrated oil companies revised their investment strategies. They shifted their investment plans to develop large "elephant" prospects. In the United States these are located offshore or in Alaska—frequently in areas where development has been prohibited. Thus, our own policies led to a shift in capital deployment that encouraged foreign oil development over domestic.

Five, the role of independent producers has steadily increased since the mid-1980s. In the lower 48 states onshore which accounts for 60 percent of domestic oil production, the independent share has increased from about 45 percent to over 6O percent. This shift is irreversible and represents a profound change in the character of the domestic industry. Independent producers are primarily involved only in the upstream part of the industry and do not have the diverse resources of major integrated oil companies. They need different governmental policies.

For independent producers this shift in strategy by major oil companies has opened opportunities throughout the United States. While most of this effort has been in the lower 48 states onshore, independents are also moving aggressively into the offshore. At the same time, for independents to meet the challenge, they must have capital. Independents do not have the diverse resources of majors; they draw their income from the upstream part of the industry: producing oil and natural gas. Many are small business entities that draw their capital from their current production.

For these companies domestic tax policies—the AMT, limitations on the use of percentage depletion, constraints on intangible drilling costs, and efforts to limit the expensing of delay rental payments and geological and geophysical costs—constrain their capital retention and their ability to increase production. Price stability becomes a more critical concern to generate the ability to attract capital compared to other investments. They differ from major integrated companies and need policy structures that reflect these differences.

Six, independent producers account for 85 percent of wells drilled in the United States and produce 66 percent of the nation's natural gas.

In the United States, independent producers—with the capital to do it and access to the resources—are the aggressive explorationists. Their "wildcatter" image is not without merit. While they use far more sophisticated tools today, independents are still willing to develop new frontiers and rework old ones. They drill the most wells. And, they produce most of the nation's natural gas. So, as natural gas' role increases in the domestic energy supply mix, it is independents who will be the mainstay.

Seven, natural gas cannot economically be supplied to the U.S. market from outside the continental area. If it doesn't come from the U.S., it must come from either Canada or Mexico. Currently, Mexico does not export natural gas.

Natural gas differs from oil in one key respect—transportability. As a liquid, oil can be loaded on ships and sent around the world. Gas isn't as easy to move across oceans. Economically, natural gas must be supplied in large volume in the continental area where it is found. In North America, that means that the supply sources for the United States are domestic production, Canada, and Mexico. Today, U.S. supplies come from domestic production and Canada.

Eight, the National Petroleum Council's Natural Gas study estimates that domestic natural gas supply must reach 29 trillion cubic feet per year by 2010. Natural gas and crude oil are intrinsically related—they are found together, they are produced together, and they require the same industry. Without a healthy domestic oil industry, we cannot have a healthy domestic natural gas industry, and we cannot meet future needs.

Natural gas is a key fuel to America's future. All credible energy studies predict the need for increased domestic natural gas use. It is a significant task. Building to a supply level of 29 or 30 trillion cubic feet per year by 2010 requires not just the development of new reserves but the replacement of existing ones. It will require capital, access to resources, technology, and a trained workforce. It will also require a clear understanding that crude oil production and natural gas production are intrinsically related. Physically, they exist together. Physically, they are produced together. Economically, they require the same industry skills, the same capital, the same workforce. We cannot achieve the national goals for natural gas use without a healthy domestic oil industry.

For all these reasons we should be developing national policies to maintain and enhance domestic oil and natural gas production—but we have not. Over the past

15 years this nation has made policy choices that strip capital from domestic oil and natural gas production, limit access to essential resources, aid foreign producers, and under the guise of environmental righteousness limit logical options.

Let me address some of these.

- *The 1986 tax reform act stripped away critical capital after the 1986 oil price crisis through elements like the creation of the Alternative Minimum Tax. Some of this effect was corrected in 1992 amendments. Now Congress has embraced a series of sound modifications to the tax code affecting independent producers. These were included in tax bill passed by Congress last year, but President Clinton vetoed the bill Congress and the Administration need to act jointly on these issues.*

Domestic tax policy remains an important component to the maintenance and enhancement of domestic oil and natural gas production. Because domestic production must compete in a world market where foreign producer nations determine the price of oil, domestic producers cannot define the price framework and must operate within the price that exists. At the same time, domestic oil projects must compete for investors against foreign projects and against other investment opportunities. In the 1990's, their rate of return was 6 to 8 percent—paltry given the risk and capital intensive nature of the industry and certainly compared to the returns from many new high technology and Internet companies. Even government-regulated sectors, like pipelines and utilities, have typical returns between 12 and 14 percent.

It is in this context that one must look at the role of the federal tax code. The tax code determines how much income oil and gas producers will retain and how much capital will be available for reinvestment in maintaining production or developing new production. It influences the rate of return on projects and therefore the appeal of a project to investors. Independent producers typically drill off their cash flow. That is, they must have producing operations generating revenue to maintain and develop properties. Historically, independents have "plowed back" 100% of their after tax revenues into their operations. Thus, when their tax burden is reduced, it means more funding for domestic production of vitally needed oil and natural gas.

Clearly, at a time when we are trying to improve national security and when our imports of foreign oil already exceed our domestic production, it is counterproductive to tilt the incentives for investment to "push" more investment overseas, or limit its availability in the U.S. Many other countries allow full cost recovery before applying any income tax. The U.S. rules are already more complex and produce an overall higher tax rate on oil and gas development than many if not most foreign countries. Several industry analytic companies have evaluated the investment climate in the U.S. versus foreign countries. On the basis of business and political risk for oil and gas production investment, the U.S. ranked 31st out of 111 countries. On the basis of leasing and fiscal tax policies, in a ranking system where individual states were compared to countries, the state of Texas ranked 180th. These analyses point to the problems facing investment in domestic oil and natural gas production.

Domestic tax policy needs to be crafted to encourage the maintenance and enhancement of domestic oil and natural gas production. The tax bill passed by Congress last year included five key provisions that would help retain capital for domestic production. These need to be included in the tax code.

Similarly, the National Petroleum Council's *Marginal Wells* study concluded that a marginal wells tax credit would provide countercyclical protection to the vulnerable marginal wells that produce about 20 percent of domestic crude oil and represent this nation's true strategic petroleum reserve. Last year, Congress at least appeared to be moving toward tax policies that would help the investment climate for domestic oil and natural gas production.

But, we must be watchful. Two of the current presidential candidates have proposed tax plans that would attack key elements of the current tax code that provide capital to the independent producer.

- *A linchpin to develop gas supplies consistent with the determinations of the NPC Natural Gas study is access to resources. Yet, successive administrations have created offshore moratoriums to prevent environmentally safe development of domestic resources off California, in the Gulf of Mexico and in the Atlantic. The most egregious of these actions was in 1998. After going through the charade of commissioning a study of the risk to the oceans from offshore development—a study that stated unequivocally that offshore development was environmentally sound—President Clinton extended the California offshore moratorium another decade.*

For decades the nation has deliberated the use of its offshore resources with mixed results. In the Gulf of Mexico where drilling and production has been allowed, offshore development has provided substantial oil and natural gas resources to the nation. Offshore production now accounts for roughly 20 percent of domestic oil production and over 25 percent of natural gas production. This production has been both a technological and environmental success story. On the other side of the coin, unreasonable opposition to the offshore development of California and other areas has limited use of these potential resources. Under the guise of environmental righteousness, the nation is denied resources that can be produced in a clearly environmentally sound manner.

During the 1998 Year of the Ocean activities, the Heinz Center for Science, Economics and the Environment analyzed the history and potential of offshore production for the National Oceanic and Atmospheric Administration. It was unequivocal in its conclusions that offshore production can be done and done well. Yet, the Clinton Administration ignored this assessment as it imposed another ten year extension to the California offshore moratorium.

• *For well over two decades we have debated whether to open the Arctic National Wildlife Refuge (ANWR) Coastal Plain to oil and natural gas development. It could yield a field on a par with Prudhoe Bay. Development has never occurred under the guise of environmental righteousness. Now, the latest question is whether the Clinton Administration will use the Antiquities Act again to wall off any development.*

Debate over the use of ANWR parallels the offshore debate. The nation is losing access to valuable potential resources that can be produced in an environmentally sound manner. The latest question will be whether the Clinton Administration will use the Antiquities Act to designate the area as a National Monument to prevent its development.

• *On a broader scale the Clinton Administration has consistently closed off access to national resources. In addition to offshore moratoriums and opposition to ANWR development, it has initiated policies to prevent access to forestland by preventing road construction. It has denied permits on federal land. It is an attitude that also pervades Congress. For example, the House has passed legislation to prohibit the development of natural gas resources under Mosquito Creek Lake in my home state of Ohio.*

• *IPAA initiated a Section 232 request regarding the level of crude oil imports in 1993. Despite a clear determination that the level posed a threat to national security, the Clinton Administration proposed no concrete policies to enhance or maintain domestic oil production. As mentioned earlier, another Section 232 assessment is pending. It needs to include provisions that are designed to maintain and enhance domestic oil and natural gas production.*

No Section 232 analysis has concluded that oil import levels do not pose a threat to national security. Now is the time to recognize that while the steps to improve energy efficiency, develop alternate fuels, diversify import sources, and other steps are useful, they are worthless without a strong domestic oil and natural gas production industry. Without sound policies that support domestic marginal well production, the nation loses its true strategic petroleum reserve. Without sound policies that support domestic natural gas production, the nation's most plentiful "alternate" fuel will never meet its potential.

• *The Environmental Protection Agency develops policies that undermine the domestic resources. For example, after initially opposing an erroneous court interpretation of the scope of underground injection control under the Safe Drinking Water Act, the EPA now opposes legislation to structure the law as it was originally intended, EPA's original position before the court.*

The 11th Circuit Court of Appeals in the *LEAF v EPA* case erroneously interpreted the scope of the Safe Drinking Water Act's Underground Injection Control (UIC) program. It ruled that the UIC program applied to the injection of fluids for the purpose of hydraulically fracturing geological formations to stimulate reservoirs for oil and natural gas production. EPA argued against this interpretation of the law in the case, a case where no environmental damage was shown. It lost. Subsequently, the State of Alabama was threatened with the loss of its primacy to run the UIC program for coal bed methane operations. EPA compelled Alabama to require the use of federally certified drinking water in hydraulic fracturing operations at substantial cost with no environmental benefit. However, EPA now opposes legislation that would correct the erroneous court decision.

If this Court interpretation is allowed to stand, it could threaten normal safe hydraulic fracturing operations at all oil and gas operations in all states. Congress must act. LEAF has filed another action in the Circuit Court seeking a review of the EPA action in Alabama.

• *Implementation of the limited emergency oil and gas loan guarantee program has been so constrained that no loan guarantees have yet to be provided. Yet, in 1998 when oil prices were at their lows, the United States was sending funding to Russia and Mexico to develop their oil industries. We have shown more interest in a pipeline across Turkey than preserving domestic resources.*

Last year after considerable delay, Congress passed the Emergency Oil and Gas Loan Guarantee Program. While the congressionally imposed restraints on the program make it complicated to implement, the interpretation of the law by the Loan Guarantee Board has so limited the program that it has scared off many potential banks and producers from seeking the financial assistance. To date the first guarantee has yet to be granted and less than 25 applications have been received.

At the same time many independent producers are frustrated that while Congress was delaying action on this program and making it too constrained, while the Administration was further limiting its application, the United States was sending funding to Mexico and Russia to enhance their oil production operations during the depths of the oil price crisis.

- *The Strategic Petroleum Reserve has been manipulated for budget tricks. Now, there are persistent efforts to use it to influence prices rather than when supplies are in jeopardy.*

IPAA has consistently sought two objectives with regard to strategic reserves of petroleum. First, the nation needs to recognize the role of its marginal wells as a true strategic petroleum reserve that produces crude volumes approximately equal to imports from Saudi Arabia.

Second, the Strategic Petroleum Reserve was created to deal with supply disruptions of crude oil; it should not be used to influence the market. IPAA objects to selling oil for budget purposes or releasing oil to affect prices.

As a nation we must define policies that recognize the ongoing importance of domestic oil and natural gas supplies. We cannot continue the current path of trashing crude oil as environmentally evil and banking on natural gas to meet future fuel needs.

We cannot continue a policy of reliance on foreign oil at prices that destroy the domestic producer. It will place our energy and economic future in the hands of foreign governments—first because we will lose our domestic oil resources, second because we will not be able to develop our domestic natural gas.

Instead, we must work together—both here in the United States and with foreign producer nations—to develop a stable oil and natural gas development framework. The next several months will test our resolve. Price pressures will continue. The Section 232 action will be completed. Policymakers can establish a sound framework for the future of domestic energy, or they can continue the failed policies of the past. Let's hope for the right choice.

Mr. BARTON. Thank you, sir. We now want to hear from Mr. Neal Wolkoff, who is the Executive Vice President for the New York Mercantile Exchange, for 5 minutes, please, sir.

STATEMENT OF NEAL WOLKOFF

Mr. WOLKOFF. Thank you, Mr. Chairman, for the invitation to appear. I'd like to take a moment of my time to describe NYMEX, the New York Mercantile Exchange. It was described in a rather colorful way a bit earlier, but I'd like to expand on some of the things said about us today.

We occupy a fairly unique position, vis-a-vis the witnesses that have testified today before this committee. We are a federally chartered and regulated commodity future exchange. We are a market place. We are completely price neutral and have no vested interest either in higher or lower energy prices. Our markets in energy include crude oil, heating oil, unleaded gasoline, and natural gas, and the prices determined at NYMEX are arrived at in a completely open and competitive auction market. Important to note, it's a zero sum market. So for every dollar that someone earns at NYMEX, another participant loses that dollar, as well.

Our prices are accepted worldwide as benchmarks for the various commodities that are represented. As part of our responsibilities in operating a public marketplace for strategically important commodities, we are required by the Federal Government to be self regulating. NYMEX oversees its markets, to ensure that NYMEX's prices represent supply and demand fundamentals; in other words, we monitor our markets, to assure price integrity and to protect against manipulation, and the exchange provides a structure of rules and policies that put teeth into the surveillance efforts.

What we have seen in energy prices since the beginning of last year is a tripling of crude oil prices. As the feed stock for refined products, including gasoline, heating oil, and diesel fuel, sharp increases in crude have resulted in similar and very noticeable price increases in those fundamentally important products.

I'd like to summarize, very briefly, what our findings are about the fundamental of these and to conclude in sum that the increases in price that we have seen are due to fundamentals of supply and demand and not due to price manipulation or any other artificial pricing. As has been said before, there has been a reduction in OPEC production. It's a 12 percent cut in production. But what hasn't been said, and I think it's important to offer some perspective just on how sensitive the oil pricing mechanism is and what an inexact science it is to predict oil pricing. We've seen as a result, a 4 million barrel a day reduction in crude production by OPEC, out of total world production of nearly 80 million barrels, a tripling of energy prices over the last year. It is a very price sensitive market, extremely sensitive to the slightest provocations of changes in supply or sudden changes of demand.

Earlier this year, we had a 13 percent increase in heating oil demand, in the first 6 weeks of January and February, mainly due to cold weather. That, on top of a 12 percent cut in production, was, in many respects, behind the spike that we saw in the northeast. Gasoline demand nationwide is matching last year's demand, which was at a record, and last year's supply was plentiful and prices were low. We've seen that price has not yet been a catalyst for any meaningful conservation, a word, by the way, that I think I've just mentioned for the first time today.

Inventories of crude and products reached at least 10 year lows a few weeks ago. Refinery utilization, which means how much available refinery capacity is being used, is well below the average over the last 5 years. A significant cause in something that hasn't been mentioned today has been unexpected maintenance in many important refineries during the month of January. But, certainly, the suddenness in the rise of crude and the expectation that those high prices are temporary have not encouraged high inventories or maximum refinery utilization.

What is not a factor, I would like to add, is market speculation. There is overwhelming commercial use of the marketplace. I would like to ask what the market would be like without price transparency in times of shortage of supply. As I've said, it's a very fragile market and without transparency, prices would be determined in a non-public way. I think we would have seen even higher prices than we did.

In addition to high prices, we have, also, been dealing with price spikes, that is one actual and one, I think, to which a great deal of fear has been instilled in the public mind about coming times. I think it's important just to understand what a price spike is and why it happens, and I would briefly like to touch on that. It starts with low inventories and added to that, a sudden change in demand. Inventories normally cushion price impacts from demand

and when the inventories are low, we can sometimes see price spikes, an inventory shortage causing State price volatility.

Typically, these spikes are painful, but short lived, and the marketplaces tended to quickly normalize the situation, as the earlier chart shown by the EIA demonstrated. In answer to the chairman's question, typical fuel oil prices today are between $1.10 and $1.20, at the retail level.

And my final comment, on the SPR, the issue of release and the issue of SPR swaps—I almost said swipes and perhaps that would have been more appropriate. We are fundamentally opposed to that and see it as an opening of a door to market intervention that, in the past, is shown to be completely unsuccessful. Thank you.

[The prepared statement of Neal Wolkoff follows:]

New York
Mercantile Exchange
NYMEX/COMEX. Two divisions, one marketplace

Statement of Neal L. Wolkoff, Executive Vice President
New York Mercantile Exchange
Before The U.S. House of Representatives Committee on Commerce
Subcommittee on Energy and Power

March 9, 2000

Mr. Chairman, my name is Neal Wolkoff. I am the Executive Vice President of the New York Mercantile Exchange ("NYMEX" or the "Exchange"). On behalf of the Exchange, I wish to thank you for the opportunity to participate in today's forum concerning recent events in the oil marketplace.

The New York Mercantile Exchange "NYMEX," established in 1872, is a "not-for-profit" organization comprised of 816 memberships. It is the largest energy futures exchange in the world and the only futures market in the United States devoted exclusively to pricing, hedging, and trading industrial commodities. The merger in mid-1994 with Commodity Exchange, Inc ("COMEX,") which provides a forum for trading gold, silver and high grade copper futures contracts created the world's largest physical based commodity exchange.

The Exchange pioneered the development of energy futures and options. From a modest 34,000 heating oil contracts traded in 1978, NYMEX energy futures and options volume grew to more than 89 million contracts in 1999 and now includes crude oil, gasoline, natural gas, electricity and propane in addition to heating oil.

NYMEX provides the world's most efficient forum for energy price risk management. The visible and highly competitive daily trading of energy futures and options on the exchange provide a true world reference price for each of the commodities traded. It is the Exchange's belief that over the past several months, including the most recent price moves, the heating oil futures market performed in a rational manner, that price increases experienced were due to a number of widely identified fundamental market factors including tightened supply and increased demand. Markets were closely monitored and contract liquidation has proceeded smoothly. The NYMEX system worked according to design, providing a viable price discovery and risk management forum--the functions which it is required under federal law to perform.

The Role of Futures Markets

Futures markets provide two important economic functions; price transparency (price discovery) and risk shifting (risk management).

Price transparency is the constant reporting to the world of the prices of actual trades being made at the exchange. With tens of thousands of energy contracts traded daily, each reflecting a binding commitment to make or take delivery of a specific commodity, price information is made available real time, on a virtually continuous basis, thus the "true world reference price" referred to earlier.

Risk shifting, in the secure liquid markets that NYMEX provides, allows commercial interests to "hedge" the risk of price fluctuations that could affect profitability and planning of their business operations. For the commercial participant, the result is a form of insurance against the financial adversity that can result from volatile energy prices.

Futures and Options Contracts

A futures contract is an agreement between two parties for delivery of a particular commodity at a specific time, place and price. Once initiated, a futures contract obligation can be satisfied by either taking an equal and offsetting futures position or by going through the delivery process and taking possession or making delivery of the commodity. The vast majority of market participants opt for the former, and as a result, futures contracts are primarily used as financial rather than physical management tools.

An options contract bestows upon its owner the right, but not the obligation, to buy or sell the underlying futures contract at a specified time and "strike" price. The option to buy is called a "call", and the option to sell is a "put". A major appeal of options is their similarity to term insurance. The option is purchased for a one-time fee called an option premium. Depending on how the market moves, the option may be sold for a profit, exercised, or allowed to expire worthless, with the holder's loss limited to the premium paid.

NYMEX guarantees the financial obligation associated with all contracts open on the exchange. The strength and liquidity of NYMEX is found in the financial integrity of the exchange, its commitment to the provisions of fair and orderly markets, and its clearing system. NYMEX has taken strong steps to ensure integrity, including daily price limits, customer margin requirements, speculative positions limits, market surveillance and strict financial requirements for all NYMEX members. As the world's largest and most innovative energy futures trading forum, NYMEX offers the experience and the security to help industry manage the global challenges of today's dynamic price realities.

NYMEX Also Serves a Broader Marketplace

While the principal market served by the NYMEX is that composed of businesses and individuals involved in financial risk management, the utility and necessity of its price reference functions are substantially broader, and serve a valuable public purpose by enhancing competition in the marketplace.

NYMEX's markets are widely utilized by all segments of the domestic and international oil and gas industries, and by major banking institutions, among other participants. NYMEX's prices are disseminated to the public in every major industrialized nation on a real time basis. The transparency of NYMEX's prices, and the integrity of its markets, makes NYMEX a benchmark for energy pricing around the country and the world.

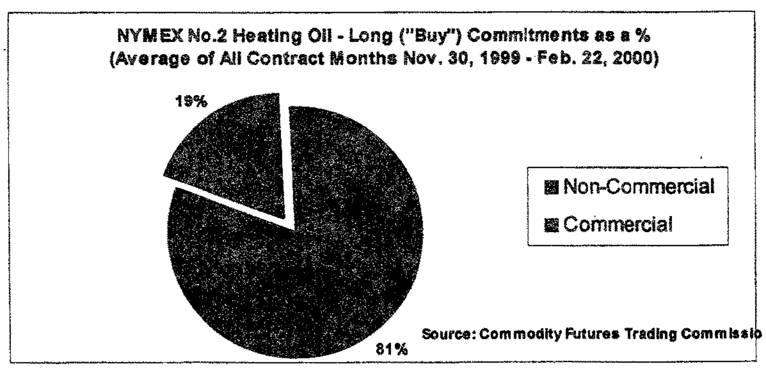
On any given day, the NYMEX energy complex averages the trading of approximately 220 million crude oil equivalent barrels per day. That represents nearly 3 times daily world oil production--and 9 times daily OPEC production, with an annual value of nearly 2 trillion dollars. However, outside the confines of the exchange, the prices reported by the NYMEX are used as references for transactions involving much larger quantities of energy products.

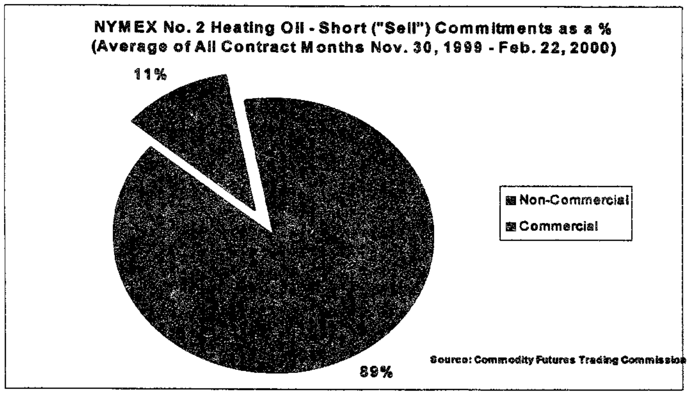
The federal government has long recognized the unique economic benefit futures trading provides for price discovery and managing price risk. In 1974, Congress created the Commodity Futures Trading Commission ("CFTC"), giving it authority to regulate commodity futures and related trading in the U.S. A primary function of the CFTC is to ensure the economic utility of futures markets as hedging and price discovery vehicles--encouraging competitiveness, efficiency, and market and trade practice integrity and fairness. The CFTC reviews the terms and conditions of proposed contracts, and oversees registration of firms and individuals who either handle customer funds or give trading advice. It conducts and monitors rule enforcement at U.S. futures exchanges.

NYMEX Market Oversight

At the Exchange, there are systems in place to ensure that, despite the fundamental forces in operation at a given time, artificial factors or manipulation cannot drive the prices of futures contracts. Our market surveillance and financial surveillance systems ensured orderly markets, including the most recent period of rapid price changes in the case of the heating oil and gasoline contracts.

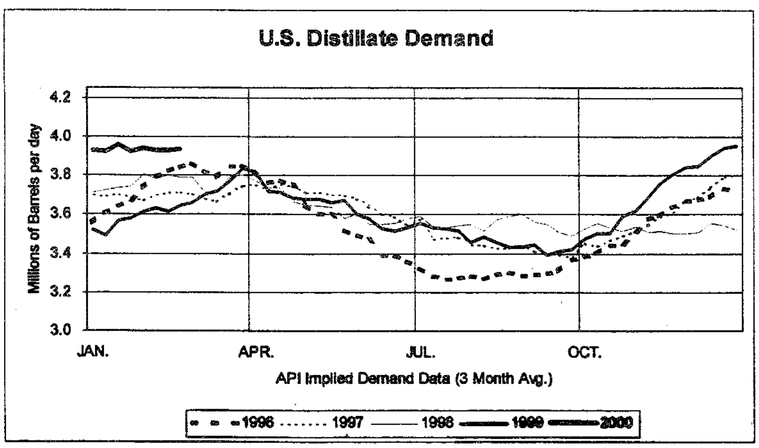
- **Speculative position limits.** Speculative position limits, or a limit on the number of contracts any one participant can hold in a single month or aggregated over all months, are an important facet of market oversight. The limits protect the market from the potential influence of large participants or concentration of positions. Speculative position limits for the heating oil and gasoline contracts are 1000 contracts (1 contract is 42,000 gallons) in the spot, or nearby contract month, 5,000 contracts in any other single month, and an overall limit of 7000 contracts in all months. NYMEX does permit hedge exemptions to the total number of positions an individual firm or group acting collectively can assume in any one month or all months combined to accommodate legitimate risk management needs of large commercial firms. There are four strict rules governing the exemptions: first, there must be sufficient liquidity in the market; second, the firm must document its cash market hedging needs; third, the firm must be appropriately capitalized and financially solvent; and fourth, the firm must have the experience to handle the size of the position. These measures serve to avoid domination by any one hedging entity, and assure that each commercial firm has the financial status to perform on its contract obligations. Large positions, defined as those entities holding 250 or more heating oil contracts, 150 or more gasoline contracts and are reported to the CFTC and NYMEX daily.



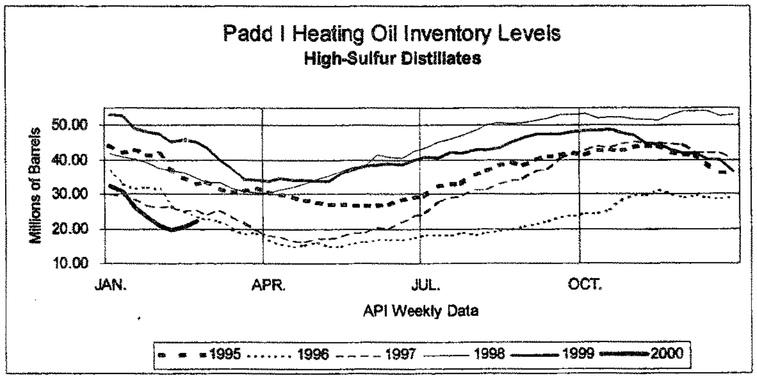


- **Market fundamentals.** Market surveillance also monitors the supply and demand fundamentals in the underlying cash market. This is to ensure that NYMEX reflects cash market price movements, that the futures market converges with the cash market at contract expiration, that there are no price distortions and no market manipulation. Market surveillance staff meets weekly to assess market conditions. The surveillance staff includes members of the compliance, operations, and research departments, and–when necessary–senior administrators. After analyzing events and developments over the past several months, surveillance staff have concluded that the heating oil and gasoline market price movements were, and continue to be, based on a number of fundamental factors::

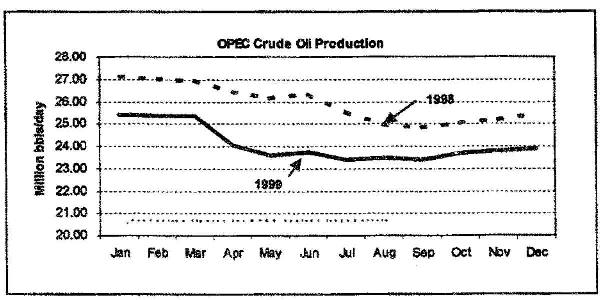
  A. **Severe winter weather.** Unusually cold January weather increased demand significantly above that experienced in recent years. A number of industrial users of natural gas with interruptible contracts apparently shifted to heating oil. Further compounding the problems were transportation difficulties caused by ice in waterway transportation systems.



B. **Lower stock levels.** PADD 1 heating oil stocks are at their lowest level since 1996–a year in which heating oil and gasoline prices spiked as well. However, since the January price spike, heating oil inventories have recovered and prices eased as the heating oil season draws to a close in the March/April time frame.



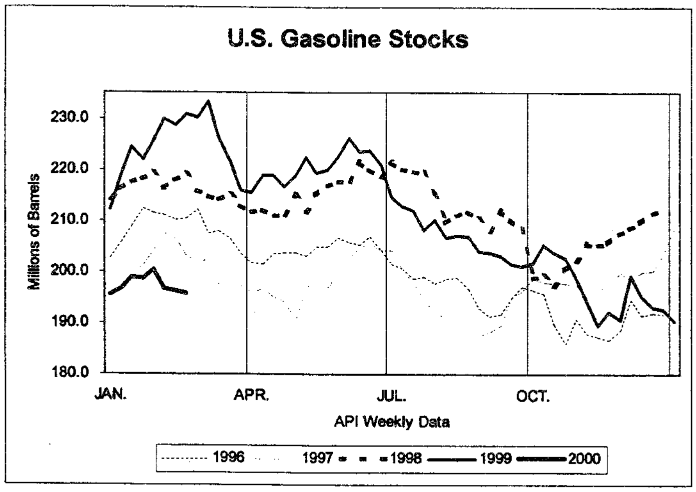
C. **Oil production reductions by OPEC.** In response to low oil prices, OPEC member nations began a program of reducing output. The production decline has amounted to a level about 12% lower than January 1998 production, has reduced available supplies, and in conjunction with demand and weather factors, has contributed to price increases.



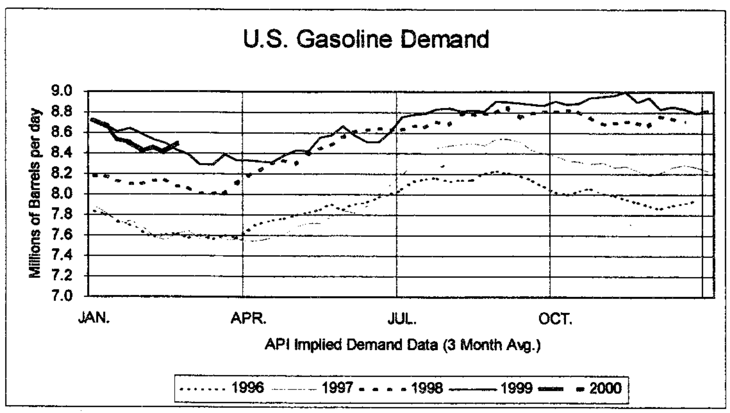
D. **Refinery outages due to maintenance and unusual events.** A number of refineries supplying the East Coast marketplace experienced shutdowns over the past several months caused by normal maintenance procedures in addition to unplanned events. Refinery problem at Sunoco Philadelphia area refinery–severely cut heating oil production from one of the largest suppliers to the New York Harbor. The Hess refinery at St. Croix was also down for unscheduled maintenance for all of January–not able to supply heating oil to New York (Hess is the #1 supplier to NY). Tosco refinery, the biggest in New Jersey had unplanned refinery maintenance which curtailed production.

Gasoline Situation–Lower Inventories and Strong Demand

A. Gasoline inventories are significantly lower relative to the past four years.



B. Demand for gasoline remains strong.



As the gasoline charts on supply and demand indicate, the current situation, when viewed in historical terms indicates a likelihood of continued volatility and price instability.

Tools Exist to Manage Energy Price Uncertainty

The current concern over heating oil and gasoline price increases has several historical antecedents. Four years ago, in late 1996, the United States Department of Energy Office of Policy began a study on the heating oil futures market. The final report, "Heating Oil Futures Markets and Price Volatility " issued last June, not only concluded that futures markets do not destabilize heating oil prices, but noted the extremely broad use of the marketplace for hedging activities as a part of energy price risk management. Sixteen years ago, the Connecticut Attorney General, after investigating a January 1984 price spike in home heating oil prices concluded that the price increase was due to market fundamentals. A similar conclusion was reached by a number of Northeastern states, including the State of New York in a hearing conducted by then-Attorney General Robert Abrams and former Commissioner of Consumer Affairs Richard Kessler, investigating a December 1990 heating oil price spike. However, among the recommendations of the 1984 investigation was that the state consider stabilizing its fuel costs for state purchase and for the Low Income Home Energy Assistance Program (LIHEAP) through the use of energy futures markets. In the years since the 1984 report, many segments of the business community including the public sector, have grown in their recognition of the value provided by the opportunity to shift to others their energy price risk. On the consuming side, states such as Delaware and Massachusetts have hedged energy price risk to protect low income and elderly recipients of home heating assistance from unexpected price spikes. On the producing side, the state of Texas has hedged the revenue stream derived from royalties on energy production. The United Nations, under the auspices of the United Nations Conference on Trade and Development (UNCTAD) has developed and implemented an energy price risk management training program for developing countries to use to manage energy costs.

By not fully using available risk management tools for energy prices, businesses and governments are exposed to the effects of rising energy prices, and are not in as good a position as it might be to extend emergency funds to the needy. Unprotected state and federal funds are "eaten up" instead by unanticipated energy cost increases. While there are costs associated with hedging, it is a form of insurance against drastic price increases. The "insurance" that a sound hedging program provides, protects against just the type of unexpected financial stress that is being experienced now, and which has brought about this hearing. The use of energy futures and options on futures has the potential to rein in the unpredictability of state energy costs, and, through prudent management result in decreased energy costs to consumers and governments.

As an open and competitive marketplace, NYMEX opposes the use of the Strategic Petroleum Reserve ("SPR") in an attempt to dampen oil prices. The SPR was rightfully created to deal with strategic supply interruptions--not as a tool for market intervention. Direct government intervention in the oil market through a release or swap from the SPR interferes with the working of a free market. The efficiencies of the free market have brought consumers relatively inexpensive energy for many years. Actions to release crude oil from the SPR would have negative consequences for the marketplace and could seriously impair the ability of the energy industry to make prudent business decisions about future inventory levels and pricing. In the future, companies may actually reduce inventory levels further, when faced with the possibility of an arbitrary release of government SPR inventories, potentially creating en even more volatile price situation. In the end, the best solution is to rely on the efficiencies of the market, as they have shown to be working currently in the case of heating oil, despite the unfortunate price spikes that periodically occur.

Conclusion

NYMEX has closely monitored the heating oil and gasoline futures markets during the recent period of price increases. It is the Exchange's belief that the facts surrounding the market fundamentals of supply and demand support the conclusion that the market behaved in response to supply and demand factors, and the NYMEX market participants acted responsibly in their use of energy futures and options markets. State and local governments should avail themselves of the energy price information which is widely available, and should develop prudent risk management strategies to protect their budgets--and the taxpayers--from unanticipated energy price spikes.

Once again, on behalf of NYMEX, I wish to thank you for the opportunity to discuss the marketplace and fundamentals surrounding the energy price situation, and will be happy to answer any questions you may have.

Sticker shock

by Phillip J. Baratz, C.T.A.*

I'll just wait for prices to come down a little:. Boy, how many oil dealers have said that over the past few months? Prices, since bottoming out in mid-February (of course, it was the middle of the winter!), have staged a rally so strong, that we have only seen one move of its magnitude since the Gulf War gyrations—and that was in the fall of 1996 when prices moved to 80 cents/gallon at the rack:

Fixed and capped price offerings were put off from May 15th to June 30th. Then, from June 30th to July 31st. Then from July 31st to.... Well, you get the point. After three years of prices allowing for both good margins and fairly low prices to customers, confusion reigns over the retail oil world. Fix prices here, and guess that prices will reach new peaks in the middle of the winter? What if prices nose-dive back to 30 cents? Maybe just do nothing, and hope that customers don't mind paying $1.50/gallon. After all, they have paid it before. Yeah, but what about that guy who capped his customers at 89.9 cents/gallon? What about the Y2K issue? No one really knows how or if it will effect oil prices, but how many dealers will be putting product into secondary storage in December out of fear that their suppliers' terminals won't be operating after the New Years Day festivities? If you factor that fear (?) in, what happens to the New York Harbor to NYMEX basis differential? What good will a Merc position be if rack prices go through the roof? Yes, I do have more questions, but the question mark on my keyboard keeps sticking, so I'll stop here.

The bottom line on a lot of this stuff is that no one really knows where prices will be going. The other "bottom line" is yours, and how you are going to protect it. As hard as it is to face certain realities, the old summers of playing golf and relaxing with the family have been replaced by summers worrying about oil prices, and how to attract new customers while holding on to old ones. As local utilities continue to deregulate their systems, new competition is starting to creep into the oil marketplace. Oil customers are, as a rule, fiercely loyal to their distributors—especially customers who take "full service." But this loyalty may start to wane in light of a return to the gyrating prices that drove oil customers to gas the better part of a decade ago.

No matter how many consultants or fortune-tellers you speak with, a satisfied customer is what you are after, and the ability to control the wild swings in his price is what will keep him happy. We've spoken in this column on many occasions about the advantages of "call" options, as a hedge against increasing prices. If prices were down in the low 30's, or even the high 30's, then the rationale of fixing the cost of oil would hold some water. However, despite relative calm in the world of oil producers, no price is safe. We can't say that prices will not go to 80 cents/gallon. They just moved 25 cents, why not another 25. We also can't make the same mistake that many keep making by assuming that once the winter hits the demand will be too great to allow prices to fall 25 cents.

Take a step back, and focus on what your customer wants from you. Then call someone who can give you and your customer the security that you need. ♦

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Heating Oil Futures and Options Give Distributors Versatile Key to Innovative Marketing

By ERIC SLIFKA
Global Petroleum Corp.

Before heating oil futures came into widespread use, wholesale prices — and thus retail quotations — were defined by the integrated oil companies. To move barrels in the summer, the majors offered their dealers a limited form of price protection called summer-fill. The retailer could either agree to a fixed wholesale price with payment deferred until October, or float with the market during July, August, and September, and receive a discount for prompt payment each month. Of course, any inventories that had to be replenished during the winter were purchased at the current market prices, usually at the height of the season. Even so, prices usually rose only 3¢ to 5¢ a gallon.

As the oil markets became increasingly volatile, especially after the disruptions caused by the Islamic revolution and the Iran-Iraq war in the early 1980s, the refiners began paying more attention to management of their own price risk and cash flow and in a span of one or two seasons, the summer-fill programs disappeared.

Retailers and independent wholesale distributors were on their own, although some innovative wholesale suppliers, and even some retailers, began using the futures markets to lock in prices and then to offer price protection programs. The futures market provides an excellent means to manage this risk, from wholesale purchases and sales at the loading rack down to the retail level for individual residential accounts.

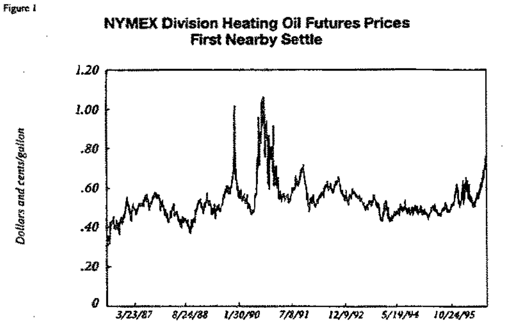
Heating oil futures trade 18 months forward, defining the price of oil for any buyer or seller — major oil company and retailer alike. Because the Exchange is a futures market, the contracts are for future barrels, not spot barrels. Eventually, of course, the futures barrel becomes a wet delivered barrel but, along the way, the distributor can lock in a price level to stabilize his costs in a market that can be volatile (Figure 1) and has been prone to spikes, even in relatively short spans of time (Figure 2).

Several years ago, after extremely cold weather and the Persian Gulf crisis whipsawed heating oil consumers for two consecutive seasons, heating oil distributors increasingly began taking advantage of the futures market to offer their customers — whether wholesale, commercial, or retail residential accounts — fixed price contracts.

A heating oil distributor always has to maintain a balance between the desire of his suppliers to maximize their revenue, and the desire of his customers to buy as economically as possible. In volatile markets, it increasingly becomes a juggling act to buy competitively while maintaining supply relationships and simultaneously remaining competitive on the

Heating oil price protection programs, made possible by NYMEX Division futures and options, ca[illegible]lunt seasonal price spikes.

Figure 1



sales side.

Generally, refiners have much greater price sensitivity than consumers. The fact is, for a favorable price move of 50 points, a refiner might run another 50,000 barrels per day through his plant.

Consumers, on the other hand, appear to be more inured to price movements especially if the fluctuations are relatively small, possibly because they have gotten used to the comfort of knowing in advance what their prices will be for the season.

A company like ours, which offers seasonal fixed-priced sales to wholesale and retail customers, will frequently find that the best solution to balancing these commitments against variable acquisition costs is to put on straightforward hedges, buying heating oil futures sometimes as long as a year in advance.

For example, during this past October, even as the 1996 heating season was getting underway, a rack customer (either a heating oil retailer who buys at wholesale and who has no storage of his own, or a large commercial consumer) wanted to lock in a price one year forward for November 1997 at the then-current futures price of 58.35¢ per gallon. That gives the wholesale distribution company a forward cash sale of 1,000 barrels at the November 1997 futures price plus any differentials for terminalling charges, transportation, other costs, and wholesaler's margin.

The distributor bought a November 1997 heating oil futures contract to lock in his acquisition cost, and now has a long futures position on one side and a short cash position on the other. By next fall, the distributor will have 100,000 barrels, for example, in November cash sales commitments at the rack, covered by 100,000 barrels of long futures positions.

Similar commitments will be made throughout the year covering the various monthly volumes required for the entire October-to-March heating season.

To cover his November obligation, for example, in the fall, the distributor will enter into an exchange of futures for physicals (EFP) with a barge or cargo supplier to take delivery of 100,000 barrels commencing November 1.

Then, when the November futures contract is about to go off the board, the long futures position is booked out by the short on the EFP (Figure 3).

Actually, this process occurs for each delivery month during the year, because commercial and industrial customers need to be supplied year-round and many residential customers use oil-fired water heaters.

Wholesale distributors should be able to go into the cash markets and purchase physical barge and cargo supplies forward, fixing the differential to the exchange.

This can be achieved in different ways with various levels of risk. A supplier could lock in cargo supplies in the summertime for winter consumption by estimating the amount of fixed price business that he will have for the coming winter. For most distributors, this volume is historically

Figure 2

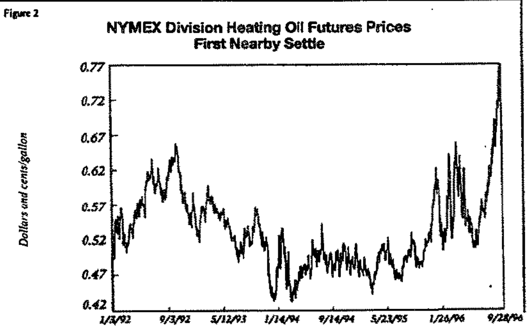


Figure 3

NYMEX Division	Cash Market
During the year:	
Buy 100,000 bbls of Nov 97 HO futures.	Sell forward 100,000 bbls for Nov 97 at Boston rack.
Fall 1997:	
	Enter into an EFP with barge or cargo supplier for delivery of 100,000 bbls at a differential to futures, commencing Nov 1.
	Take delivery of 100,000 bbls for sale to customers an an EFP.
Take short futures position under the EFP, booking out futures position.	
Result:	
Long futures position is offset by short EFP. Position is flat.	Physical supply is obtained, commitment to supply 100,000 wet barrels is fulfilled. Position is flat.

stable. For example, the supplier may have 250,000 barrels of fixed price sales in December and another 350,000 barrels of sales in January. The supplier would then look to the market to buy cargoes for each of these months on EFPs locking in the basis differentials, guaranteeing his cost of product.

The basis between New York Harbor, the delivery location of the futures, and another city, such as Boston, can usually be covered by buying cargoes forward at a differential to heating oil futures or by looking for wet barrels toward the end of the month that someone is selling for delivery in 10 or 15 days. If, in the rare event, the physical supplies are not available at a reasonable price, perhaps because of a spike in cash market prices, delivery can always be taken against the futures contract, the only extra cost being the transportation from New York.

In the cash markets, distributors generally have a substantial portion of their volume covered by contracts with refiners, although these agreements are essentially guarantees of volume. Unlike years ago, the supply contracts do not stipulate fixed prices, although they are indexed, usually to the heating oil futures market or to an independent pricing service such as *Platt's Oilgram*, because distributors cannot incur the price risk on the downside and refiners can't incur the price risk on the upside. So both work off an index which fluctuates day-to-day, but in theory means the distributor will never lose his shirt.

Our firm has a residential customer base in suburban Boston, and a large share of that business is done on a fixed price basis. Last summer, we put on hedges that allowed us to quote a retail price for this heating season of $1.04 per gallon, which met our targets for retail margins and seemed like a reasonable price level considering that no one knew what was going to happen this winter. For a variety of reasons, the wholesale markets were quite strong this fall, and prices have rapidly moved to the highest levels seen since the Persian Gulf crisis. By early November, retail heating oil prices in Boston were almost $1.30 per gallon, and some principal Northeastern markets were posted as high as $1.40.

At the same time, some of our wholesale rack customers also buy on a fixed price basis, and the obligations for those barrels are covered in the same way.

Of course, we are not the only heating oil company selling on a fixed price basis, but only suppliers who have covered their physical sales with physical barrels as well as futures are truly hedged.

In the case of small retailers who do not have storage, or who load their delivery trucks at wholesalers who in turn buy the physicals forward, the wholesaler does the hedging on their behalf.

At that point, the Exchange becomes a great resource for consumers, from power plants to apartment buildings to individual households that consume 800 gallons a year.

The flexibility and liquidity of the Exchange-traded market allows these end-users to obtain energy price guarantees for a defined period of time. In fact, the Exchange has provided the energy producers and consumers with a potential way of balancing supply and demand fundamentals.

In order for consumers to be protected against price spikes, they must be willing to make a commitment for the season with their retailer or bulk supplier, and the heating oil industry must look for ways to more closely link producers and consumers. The Exchange's heating oil futures contract, and its many on-exchange derivatives — options, crack spreads, crack spread options, calendar spreads, and strips — provides extremely versatile instruments and strategies to stabilize costs and take the guess-work out of wintertime budgeting. ■

Eric Slifka is general manager of Global Petroleum, a Waltham, Massachusetts-based wholesaler, retailer, and trader of a full slate of clean refined products, residual fuel oil, and natural gas.

The company conducts business throughout the United States.

Pri¢e Risk Management

Various strategies exist to

minimize your exposure to oil price volatility

By Rick Trout

First of all, why should you want to manage price risk? We all know that distillate supply can be more or less than adequate and that petroleum product prices are volatile. Like it or not, we have to live with it and we have to deal with it. Those who sell heating oil also have to deal with weather uncertainty, which can also be referred to as demand volatility. Put them all together and you have March and April 1996. At that time heating oil supply was at typical end-of-winter levels. However, extended cold weather caused demand to outstrip available supplies and consequently prices shot up. So what happens to marketers when prices spike? As wholesale prices increase, retail prices increase less and the marketer's margin is squeezed. And even though retail prices aren't increasing as much as they should, your customers are complaining and in some cases they are switching suppliers or even fuels. The goal of managing price risk is to reduce price volatility, protect your margin and keep your customers happier.

Assuming you consider that to be an important goal, I will now describe a few programs that are available to you to manage price risk. Most major and regional heating oil wholesalers offer "wet barrel" risk management programs to their marketer customers. You can also do risk management with "paper" programs through a broker, or a combination of wet and paper, but my presentation will focus on wet barrel risk management programs only.

All basic wet barrel programs offer one elemental feature: upside protection or protection against rising prices. The simplest and least costly of these offerings is the Fixed Price Program. With this program, you agree to take 42,000 gallon increments of product at a designated terminal in a designated month at a designated price. The designated price is the New York Mercantile (or "Merc") price at the time you buy your contract plus a terminal differential. Keep in mind that the Merc price is a New York Harbor price. The terminal differential covers the cost of transporting the product to the designated terminal, as well as the cost of storage and handling at
the terminal, as well as profit for the supplier.

Buying a Fixed Price contract is similar to buying physical product and holding it in storage. And if prices go down, your inventory loses value. In other words, a fixed price contract gives excellent protection against rising prices, but no protection against falling prices.

Because of downside price risk, most suppliers also offer a Cap Price Program. This program has two elements: (1) a cap or maximum price which gives the buyer protection against rising prices and (2) a provision that if the Merc price falls, your buying price falls with it, thus giving you protection against declining prices, no matter how far they fall. This is called full downside protection.

You pay a premium for the downside protection, the cost of eliminating risk. The amount of this premium is generally the cost of buying an option on the Merc. The cost of an option varies according to three basic elements. It is highest when your Cap is at the market price, your contract is several months out and the market is highly volatile. The cost of an option is lower when your Cap is above the market price, your contract is for a near month and the
market is moderately volatile. Most

suppliers will quote you a Cap premium without you making a buying commitment, so that you can evaluate the affordability of the full downside protection.

A third program offered by most suppliers is the Collar Or Min-Max Program. This program has two elements: (1) a cap or maximum price which gives the buyer protection against rising prices and (2) a provision that if the Merc falls, your buying price falls with it to a point you prescribe, usually referred to as the floor or minimum price. This is called partial downside protection.

Here again, you pay a premium for the downside protection, but the Collar premium is lower than the Cap premium because you receive less downside protection. The amount of the Collar premium is determined by the same market elements that affected the amount of the Cap premium, plus one additional factor. These four elements are: where your cap is relative to the market price, where your floor is relative to the market price, time 'til the contract month and market volatility. Once again, most suppliers will quote you a Collar premium without you making a buying commitment, so that you can evaluate the affordability of the partial downside protection.

What I have just described to you are the three fundamental wet barrel risk management programs offered by suppliers: Fixed Price contracts, Caps and Collars. They all offer upside protection. They differ according to the amount of downside protection they offer, if any, and the various associated costs.

In summary, Fixed Price contracts have no downside protection and cost the least. Collars have partial downside protection and cost more than Fixed Price contracts. Caps have full downside protection and cost more than Collars.

Knowing what risk management tools are available is not the entire price protection story. The rest of the story is knowing how and when to use these tools.

For example, if you want to offer or are compelled by your competition to offer fixed price or cap price gallons to your retail customers, then you should consider using risk management programs in the context of a hedging strategy.

That means that if you sell fixed price at retail, you buy a similar volume of fixed price at wholesale and the difference between the two prices is your locked-in margin. You have transferred the risk to your customer and you have created a low risk situation for yourself at low cost. Your concerns should be (1) is the locked-in margin sufficient and (2) will the retail customers renege in a falling market?

One way to take the risk away from your retail customers, in a market where the price is high by historical standards, is to sell them retail cap price gallons. A hedging strategy requires that you buy a similar volume of Caps at wholesale and the difference between the two cap prices is your locked-in margin. Here you have created a low risk situation for both yourself and the retail customer, at high cost. Will the retail market allow you to pass on the Cap premium to your retail customers? If not, the locked-in margin may or may not be sufficient for you to use this type of hedging strategy.

Even if you don't sell fixed price or cap price gallons to your retail customers, you may want to use risk management programs to minimize price volatility and protect against margin squeeze in the context of a market view strategy.

A market view strategy is based on your view of the market. It is based on your view of current market price versus historical market prices. It is based on your view of actual and potential world and petroleum industry events and their likely impact on distillate prices.

For example, many people view 70 cent wholesale heating oil as high versus recent historical market prices and therefore feel that there is a downside risk associated with that price level. They are concerned about falling prices or perhaps both rising and falling prices.

Another example of market view would be your view of Tosco bringing the Trainor refinery back on stream and the likely impact it will have on supply and prices.

Obviously, the market view approach requires that you have an awareness of both historical market prices and current events. If this is not feasible, you may want to consider utilizing the services of a consultant.

Whatever your market view, there are certain risks associated with it. A market view strategy seeks to protect against these perceived risks by utilizing an appropriate risk management program. However, most market view strategies are not risk-free. For example, your market view may be incorrect. Even if you are correct, some price volatility exposure may still exist. Therefore, as you are about to see,
market view strategies range from very low risk to very high risk.

Here is the first of five basic market view strategies. If a marketer is solely concerned about falling prices, he should buy at current market price. This strategy is low cost and very high risk, the risk being that you're unprotected against rising prices.

Next, if a marketer is solely concerned about rising prices, he should buy Fixed Price contracts. This strategy is low cost and high risk, the risk being that you are unprotected against falling prices. This strategy is not as high risk as the previous strategy, in that prices usually have more room to rise than to fall.

A marketer concerned about both
rising and falling prices may buy a combination of Fixed Price contracts and product at current market price. The ratio between these two low cost elements determines risk level, with an even balance presenting the least risk. This strategy should result in the marketer hitting a single, double or triple, rather than a home run or a strike out. Strike outs can be disastrous and many people are willing to give up home runs to avoid them.

A marketer concerned about both
rising and falling prices, who views downside risk as moderate, may buy Collar contracts. The amount of downside protection purchased determines risk level and cost, with less risk resulting in higher cost.

Lastly, a marketer concerned about both rising and falling prices, who views downside risk as high and who has enough margin to absorb the high cost, may buy Cap contracts. This is a very low risk strategy.

Now that you've heard about the two hedging strategies and the five market view strategies, I want to show you a matrix that depicts the risk/cost relationship for the seven risk management strategies.

Please bear in mind that current
market price versus historical market prices has some impact on this matrix that is not shown. For example, a Fixed Price contract when today's price is low versus historical prices is less risky than a Fixed Price contract when today's price is moderate or high versus historical prices. The basic matrix illustrates that in almost all cases, the lower the cost of the strategy, the higher the risk...and the higher the cost, the lower the risk. There is one notable exception to this general risk/cost relationship: the Fixed Price hedging strategy is both low cost and low risk, a fact worth remembering.

So how do you determine which strategy is best for your company? It's a process of elimination:

1. Do you sell Fixed Price at retail? If so, use a Fixed Price hedging strategy.

2. Do you sell Cap Price at retail? If so, use a Cap Price hedging strategy.

At this point, if you haven't settled on a hedging strategy, it's time to put your market view to work.

3. Is today's price very high and you're solely concerned about falling prices? If so, use a current market price strategy.

4. Is today's price very low and you're solely concerned about rising prices? If so, use a Fixed Price strategy.

5. Are you concerned about both
rising and falling prices? And is low cost a primary concern, even if it means taking more risk? If so, use a combination Fixed Price/current market price strategy.

6. Are you concerned about both
rising and falling prices? Do you view downside risk as moderate and are you able to pay a little higher cost? If so, use a collar strategy.

7. Finally, are you concerned about both rising and falling prices? Do you view downside risk as high and are you able to pay a high

cost to eliminate this risk? If so, use a Cap strategy.

That completes the risk management process, a process that includes hedging, market view, program cost and risk tolerance. If this process leads you to buy Fixed Price contracts, be very careful about trying to hit or nearly hit the market low. Prices may take off on you while you're waiting for them to drop to a certain level, as they did this past June, and you may miss the boat. Since the market low is difficult to predict, you may be wise to layer-in your Fixed Price contracts at various points in time, similar to the "dollar cost averaging" approach to investing.

There are some benefits offered by wet barrel programs that are not offered by paper programs. First, with wet barrel programs, the supplier takes on the basis risk, not you. This means that if the normal relationship between Merc price and rack price at your terminal of choice "blows out", such as it did at the end of last winter, the supplier absorbs the distortion, not you. With paper programs, you absorb the price distortion.

Second, many wet barrel programs require no money up front, even when options are involved. This is not the case with paper programs.

Third, some marketers like to buy wet barrel Fixed Price contracts for upside protection and Put options through a broker for downside protection. This is two-stop-shopping. Instead, you can enjoy the convenience of one-stop shopping by buying a wet barrel contract that protects both ways, either a Cap or Collar contract.

And finally, if you buy an out-of-the-money Put option through a broker, a vehicle that provides you with partial downside protection, you are subject to a downside loss until your downside protection kicks in. A small drop in price results in a loss for you. Wet barrel partial downside protection immediately protects you on the downside until your downside protection kicks out. A small drop in price does not result in a loss for you.

Example of Combination Fixed Price/Current Market Price Risk Management Strategy

Let's say your goal is to price protect 84,000 gals. in December. You buy 42,000 gals. At a fixed price of $.60 cents per gallon and you let 42,000 gals. float with the market (rack) price.

If the market goes up to $.70, your average price for the 84,000 gals. is $.65. If the market goes down to $.50, your average price for the 84,000 gals. is $.55.

What have you accomplished? You have reduced the range of prices from $.50 - $.70 to $.55 - $.65, thereby reducing the severity of price volatility.

Example of Choosing Risk Management Strategies That Meet Your Needs

Let's say a dealer sells 30% of his retail volume at a fixed price of $.999 cents-per-gal. The NYMEX price is $.54 and the location differential is $.03, for a wholesale fixed price of $.57. The margin between $.999 and $.57 is $.429. The dealer cal live with this margin and he buys Fixed Price Contracts, thereby using a Fixed Price Hedging Strategy.

A few months after buying the Fixed Price Contracts, the NYMEX has risen to $.62 and the dealer becomes concerned about rising prices and margin squeeze on his unhedged volume. The NYMEX trading range over the past couple of years has been $.48 to $.76. The dealer feels that his current downside risk is $.07 - $.12 and he decides he wants $.07 downside protection. He is also willing to take on $.03 upside risk. The dealer decides to use a Collar Strategy and buys $.03 up/$.07 down Collars, which cost $.62 NYMEX price, plus $.03 location differential, plus $.012 collar premium. His maximum price is $.692, and his minimum price is $.592.

Rick Trout is Northeast distillates manager for Mobil Oil Corp. in Fairfax, VA. He can be reached at 800-227-0707, ext. 1547.

RETURN TO MAIN MENU

STATE OF CONNECTICUT

HOME HEATING OIL STUDY:

REVIEW OF RAPID PRICE RISE IN CONNECTICUT DURING JANUARY, 1984

Conducted by the Office of The Attorney General,
And the Office Of Policy And Management — Energy Division

JULY 2, 1984

I.

Executive Summary

Situation

During January, 1984, Connecticut, New England and the Northeastern United States experienced an unprecedented rise in the price of #2 (distillate) home heating oil.

The Office of Policy and Management, Energy Division's monthly heating oil survey showed that the average wholesale price of oil in Connecticut rose 17¢ over the month between January 3, 1984 and February 1, 1984. The retail price rose 15.1¢ to $1.268/gallon on February 1, 1984.

The 15.1¢ price rise during the month of January represents the largest one month increase in the last 5 years and it occurred during a period of relatively stable and unencumbered international and domestic oil markets.

State Response

In response to the precipitous price rise in such a short period of time, Governor William A. O'Neill directed Attorney General Joseph Lieberman to review the pricing situation and to determine the reasons behind it.

With regard to the Governor's request, the Attorney General's Office, in cooperation with the Office of Policy and Management, initiated four actions:

1. A written request to the Federal Trade Commission for a Federal investigation into the reasons behind the price rise.

2. Stepped up internal review and compilation of data by the Energy Division. A tracking program for daily price change activity was established to monitor:

   o Key terminals in Connecticut, New England, the Gulf and West Coast:

   o The New York spot market and the Mercantile futures market

   o Kerosene, #2 heating oil and diesel fuel in market areas under review.

3. Coordination among Northeastern States' representatives to share individual state reviews and coordinate possible remedial action.

4. Written requests of major oil company suppliers and in-state distributors of home heating oil in Connecticut seeking a detailed explanation for increases in price.

Findings and Conclusions

A series of market characteristics and unanticipated occurrences converged this past winter and brought about the sharp wholesale and retail price increases.

The key to this sudden jump in prices is the fact that oil companies had lower inventories going into the 1983–84 season than in the past. Increased inventory this season would have provided a better cushion against the unanticipated supply losses and increased demand. It should be realized, however, that building inventories would not have actually reduced consumer costs substantially, but it would have spread out the seasonal price rise and prevented the burdensome one-month increase. Adequate inventory would also have reduced the reliance on more expensive spot market and waterborne oil sources. It may also be true that if companies build large inventories, overall consumer costs could be greater in seasons where no problems occur.

Oil companies have been lowering their inventories in recent years because of uncertain demand and out of a desire to improve profits. To alter the current inventory pattern will require some measure of government involvement, either through regulation or tax incentives. But government and consumers may well have to bear the costs of such programs.

Any government attempt to modify inventory practices should be national in scope. Higher inventories at the state level alone may not solve a short term problem like that experienced this winter.

The data suggests that, taken as a whole, total costs for the winter season were not out of line with those for recent years. What was different this year was the unusual price "spike" that occurred in January, taking consumers by surprise and causing financial strain for many, particularly those on fixed or low incomes.

Heating oil consumers in the Northeast remain vulnerable to sharp price moves during the course of a heating season whenever conditions combine to strain the supply/demand balance.

It should be noted that the oil industry's supply and distribution systems did respond to the winter oil supply problem quickly, and that oil was available to the region, albeit at substantially higher prices. We found no evidence that oil companies manipulated prices or supplies to cause the price escalation. Evidence suggests that unusual steps were taken to quickly supplement available supplies in the Northeast once supply tightness surfaced.

Recommendations:

Connecticut Energy Policy

- Connecticut must continue to vigorously pursue conservation, renewables and diversification strategies as the most efficient and cost effective methods to blunt adverse price and supply movements in the petroleum markets.

Inventory Considerations

- Connecticut strongly recommends that all segments of the petroleum industry reassess their inventory policies and the necessity for prudent and responsible actions to insure the stability of price and supply for heating oil throughout the winter.

- Connecticut, in both its roles as a purchaser of millions of gallons of fuel oil and as a provider of funds for the Low Income Energy Assistance Program, should study the feasibility of stabilizing its energy costs through the use of 1) distillate commodity futures contracts to lock in seasonal heating costs and 2) a limited state reserve or exchange program for participating vendors in the Energy Assistance Program to control residential home heating costs.

Monitoring and Assessment Activities

- The State's program for regularly monitoring the price and inventory of home heating oil should continue.

- The supplemental monitoring of spot and futures pricing activity should be made part of the regular monitoring effort.

- The State should work with its Congressional delegation and the United States Department of Energy to assure the continuation of state level price and consumption data collection by the Energy Information Administration. These programs are currently in jeopardy.

- The State should maintain communication and liaison with oil companies and dealers as an effective means of keeping abreast of developments in the industry.

Emergency Policy Perspective

- The rapid price rise during January was the result of an imbalance in the domestic supply and demand of #2 distillate fuel oil. This situation is not perceived to be a fundamental energy emergency with regard to either price or supply.

  Connecticut has always strongly supported Federal energy emergency preparedness policy initiatives with regard to national and regional strategic reserves, economic response programs and price and allocation programs as a measure of last resort. However, these policies are simply not applicable, nor would they have been effective, in this instance given the nature and duration of the of the circumstances which Connecticut experienced this past winter.

Mr. BARTON. Thank you, Mr. Wolkoff and we'll have questions for you in the question period. Now, I would like to hear from Mr. Bob Slaughter, who is representing the National Petrochemical and Refiners Association. Mr. Slaughter?

STATEMENT OF BOB SLAUGHTER

Mr. SLAUGHTER. Thank you, Mr. Chairman. I'm Bob Slaughter, General Counsel for NPRA. We represent refiners, who own about 98 percent of the U.S. refining capacity.

NPRA shares your concern about the supply and price of petroleum products. We and our members have been working with the Secretary of Energy and other officials to mitigate the adverse effects of recent supply problems in the northeast. The Secretary has asked for our members' help in maximizing the output of home heating oil and diesel and in rescheduling discretionary maintenance and repair, which could interfere with refinery output. Of course, that can be delayed only when safety considerations are not compromised. Refiners are responding to this and other requests and our cooperation has been acknowledge. We will continue to do so.

We agree with the general consensus that the northeast supply problems resulted from a sudden cold snap, the weather, and, also, from OPEC's reduction of supply. Another factor was the triggering of natural gas interruptible contracts. Frankly, the OPEC problem is beyond NPRA's control, but we support efforts to convince OPEC and non-OPEC participants that an increase in crude supply is necessary and warranted. Refiners and consumers will benefit from additional crude supplies.

Crude and product inventories seem to be on the increase and that's a good sign. Stable supplies of crude and predictable prices are important to us, too. Refiners are, also, aware of concerns that gasoline supplies for this year may be under pressure, as a result of the reduction in crude. We would have to say that these concerns are speculative at this point. Refiners excel at meeting consumers demand for petroleum products and are focused on the need to provide gasoline to consumers. We are confident that continued reliance on market forces will best help them to accomplish this task.

We are looking at all the policy options that have been discussed here and elsewhere, but we want to mention that the U.S., not long ago, experimented with an energy policy characterized by widespread government intervention in energy markets. This was found to be inefficient and costly. After several years of experience with that model, it was traded for a policy that relies on market forces to balance supply and demand. Reliance on the market has its rough spots and we are experiencing one at present, but history suggest the alternatives are worst. Also, Mr. Chairman, we support your reluctance and DOE's reluctance to tap the SPR for a temporary supply problem. The SPR is a strategic asset and is meant to address more critical situations than this.

It does seem the post examination of some policy options may help to avoid future supply problems. During the decade just past, refiners faced an unprecedented level of environmentally related investments in their facilities. The industry spent $50 billion to comply with stationary source controls alone in this timeframe.

Perhaps, as a result, the average return on capital for the industry, for 1990 to 1997, was 3 percent. This does not compare favorably with the passbook savings rate at the local bank.

We now face another round of large environmentally related spending in this decade. The chart before us shows the environmental programs for which investment will soon be required. Those that can be estimated, at this point, add up to more than $15 billion in new investment, and this does not include needed investment to maintain and expand current operating capacity to meet demand.

We're not here to seek any moratorium or a roll back of environmental progress. On the contrary, our industry has an excellent record of environmental achievement. Between 1980 and 1996, air emissions from refineries declined by 73 percent and there is more to be done. But, these programs do come at a cost and we urge the subcommittee to review the impact of perspective environmental proposals on a supply of petroleum products. We can go too far, too fast. This is especially true, if we lose refineries and capacity.

And we especially want to urge the subcommittee to examine the upcoming diesel sulpher rulemaking, which will impact both diesel and home heating oil supply. EPA seems ready to support an unreasonable level of sulfur reduction, which could endanger future diesel and home heating oil supplies, as well as refinery viability. We believe that the industry has proposed a more reasonable and equally effective approach.

I want to thank you for the interest of the subcommittee and I look forward to responding to your questions.

[The prepared statement of Bob Slaughter follows:]

PREPARED STATEMENT OF BOB SLAUGHTER, GENERAL COUNSEL AND DIRECTOR OF PUBLIC POLICY, ON BEHALF OF THE NATIONAL PETROCHEMICAL & REFINERS ASSOCIATION

Good morning. My name is Bob Slaughter. I am General Counsel and Director of Public Policy for the National Petrochemical & Refiners Association (NPRA). I am very pleased to be here this morning to address the refining industry's perspective on the fluctuations in crude oil prices and supplies over the past 12 months.

NPRA's membership includes virtually all U.S. refiners, as well as petrochemical manufacturers using processes similar to refineries. Our members own and/or operate almost 98 percent of U.S. refining capacity. NPRA includes not only the larger companies, but also many small and independent companies.

OVERVIEW

Today Americans have the benefit of a highly competitive refining industry that welcomes challenges and which produces quality supplies at market prices. Price fluctuations are driven by many factors that influence supply and demand in a competitive oil marketplace. The fluctuations which we have seen lately are the result of many events, some of which have occurred far from our shores.

In addition, our industry is currently confronted by many environmental challenges from state and federal regulators, which we plan to meet. However, contrary to popular belief, the refining industry's resources are limited and the costs of these upcoming regulatory initiatives are high.

I would like to review for you (1) what we see as some of the causes of these recent fluctuations, (2) NPRA activities with Secretary Richardson and the Department of Energy, (3) supply and distribution challenges which we see ahead for the refining industry, and (4) some future steps which we believe may be appropriate.

CAUSES OF PRICE FLUCTUATIONS AND STATUS OF CURRENT CRUDE OIL MARKETS

Early in 1999, a "glut" of oil on the world oil market drove the price of a barrel of oil down sharply. In February 1999, a barrel of crude oil was being sold for an astonishing $11. This was the result of two major factors, 1) reduced demand in Asia and to a lesser extent Europe, and 2) increased production in the Western Hemisphere. However, beginning in April, 1999 the price for crude oil began a consistent and steady increase, with a barrel of oil today (March, 2000) selling for around $30. A few events can be identified as contributing factors to the current price scenario. First, OPEC and several other exporting nations, in response to the devastatingly low price of crude oil during the 1998-1999 time frame, began to reduce the supply of oil to the world market by cutting production. This decrease in production coincided with a rejuvenation of the sagging Asian and European economies which increased the demand for crude oil on the world markets. In addition, the U.S. experienced a colder than normal late winter in 2000, especially in the Northeast, adding a greater than expected demand for heating oil. The reality of all of these factors is that the world is now consuming around 2 million barrels more than it is currently producing.

REFINERIES ARE WORKING WITH THE DEPARTMENT OF ENERGY

February 9, 2000 Meeting with Secretary Richardson

On February 9, 2000, NPRA member company representatives and staff met with Secretary Richardson regarding the current problems with heating oil supplies in New England. Refiners were encouraged to take all steps possible to increase the supply of heating oil and diesel fuel to the affected region. It was also suggested that routine maintenance and turnarounds at refineries be delayed where feasible and safe, in order to maintain distillate output. Insofar as these activities are consistent with safety and sound operating practices, some refiners have agreed to consider rescheduling minor repairs in order to maximize distillate supplies to this region. However, it must be stressed that these activities will only take place provided all necessary safety concerns are met.

February 16, 2000 Department of Energy Home Heating Oil Summit

On February 16, 2000, NPRA attended the Department of Energy's Home Heating Oil Summit in Boston, Massachusetts. Both Secretary Richardson and NPRA told the Boston meeting that the refining industry is working with DOE and others to respond to the current situation. In addition to the meeting with the Secretary, several NPRA member company representatives have provided the DOE with private information in an effort to help the Secretary and the Department of Energy assess the current situation and the near-term supply situation as he evaluates various possible responses. Refiners have also confirmed to the Secretary that efforts to ensure adequate production of heating oil and diesel fuel have been underway for weeks and are continuing. Because of competitive considerations we asked our members to deal privately and directly with the Secretary's office and his distillate supply task force, and we know that many of our members have done so. We anticipate continued contact between our members and the Secretary's office on this subject.

SUPPLY AND DISTRIBUTION CHALLENGES AHEAD FOR THE REFINING INDUSTRY

The current predicament again reminds us that the U.S. either deliberately or inadvertently has followed a national policy which, at times, doesn't pay sufficient attention to the question of supply. This is most often true in the area of environmental policy. The U.S. frequently pursues overly expensive environmental restrictions without looking for equally effective but less costly alternatives. The inevitable result is situations such as that which we are confronted with in the Northeast. The refining industry now faces extensive new Clean Air Act regulations that will take effect in the near future. These include requirements both for control of refinery emissions, New Source Review (NSR), and for the reformulation of gasoline to remove sulfur and selected ″air toxics″. Refiners are also currently making the transition into RFG II as required by the 1990 Clean Air Act Amendments. It seems certain that in addition that EPA will require the reformulation of diesel fuel, and it is likely that Congress or EPA will consider proposals which require the phase-down or even elimination of MTBE from gasoline. Attached is a chart titled, "Cumulative Regulatory Impacts on Refineries: 2000-2010," reflecting these requirements in more detail. This chart reflects the importance of the need for policymakers to begin working together with industry to balance the environmental concerns of the country with consumers' need for an adequate supply of petroleum products. I would like to briefly cite some of the environmental rulemakings the refining industry faces.

New Source Review (NSR)

Under the Clean Air Act Section 111(a)(4) and EPA's regulations, NSR is triggered by any "physical change or change in the method of operation" of a source that increases its emissions by a significant amount. If a physical/operational change does not itself significantly increase source emissions, or if the source "nets out" the change by offsetting emissions reductions in other places, then, under the law, NSR does not apply.

NSR is one of the most complicated regulatory programs ever created. EPA has recognized this and initiated the reform process to simplify and rectify the program. EPA's current approach to NSR applicability makes it extremely difficult for refiners to determine when NSR permitting and controls are required and leaves refineries in enforcement jeopardy unless they consider NSR for any and all operational changes. As a result, the program is an untenable burden on state permitting authorities and refineries and threatens their ability to implement Congress' future environmental goals in a timely manner.

The end point of EPA's current position is universal NSR. However, no industrial economy could function if every change to a factory required a permit before construction could begin. This will be particularly burdensome for refineries given the operational changes necessary to comply with the blizzard of new fuel reformulation and stationary source regulations. EPA recognized that Congress did not intend universal NSR in its 1996 proposal for NSR reform, however EPA's new approach is achieving just that.

Tier II Regulations

EPA's recently concluded rulemaking on the Tier II gasoline program is an extremely ambitious, high-stakes approach to reducing sulfur in gasoline. It requires that refining industry to make unprecedented investments in improving technology to meet the rule's timing requirements. The final Tier II rule will require the refining industry to invest as much as $8 billion in order to comply with a new 30 ppm gasoline sulfur standard effective 2004-6. Conservative estimates have stated that the cost of gasoline will rise 5 cents per gallon in response to these costs. This doubles the refining industry's recent annual environmental expenditures. Expected requirements to reformulate diesel fuel could increase these costs by as much as $4 billion, or more, depending on the extent and timing of sulfur reduction.

Diesel Fuel

Another prime example is an upcoming EPA regulation affecting diesel fuel. Truckers and others who are reliant on diesel supplies have recently protested about disruptions in the supply and price of the product. At the same time, EPA is preparing to propose a regulation drastically reducing sulfur levels in diesel fuel. NPRA is committed to improving the environmental performance of fuels, and we have endorsed a reasonable reduction in diesel sulfur. However, all indications are that the EPA proposal goes far beyond anything that could be called "reasonable."

EPA is set to propose a severe reduction in the on-highway diesel fuel sulfur standard from a cap of 500 parts per million to 15 parts per million. The agency has conducted no analysis of the impact of this reduction on diesel supply or price or on the viability of the U.S. refining industry. NPRA has told the agency that a sulfur cap of 15 ppm will severely impact refiners, resulting in the reduction of U.S. refining capacity. We think that it will severely reduce the available supply of diesel, and that heating oil and gasoline supply will also be affected if marginal refineries close, or elect not to produce on road disels. Please note that the diesel requirement would take effect at the same time as a 90% reduction in gasoline sulfur. Together these initiatives could cost the refining industry roughly $12 billion. And, the process and operating changes are not the same for gasoline and diesel—synergies do not exist between the two.

Reducing diesel fuel sulfur content to the level under consideration by EPA poses difficult technical and engineering challenges for the refining industry and imposes significant capital requirements and operating costs. There are no obvious solutions or inexpensive means to accomplish this level of reduction, and the technical capability to achieve very low sulfur levels is in question for many refineries. Very low diesel sulfur levels may also lead to other unexpected problems or unintended consequences, such as reductions in energy content, lubricity degradation, and susceptibility to contamination problems at the refinery and terminals.

As this rulemaking goes forward, policymakers must be sensitive to diesel supply implications, and the availability of technologies capable of meeting regulators' objectives. We must guard against unreasonable requirements which would threaten the viability of refineries, and cause market disruptions in the flow of critical energy products to consumers.

Urban Air Toxics

Yet another example of challenges facing the refining industry can be found in EPA's plans to regulate air toxics. Section 202 (1) of the Clean Air Act directed EPA to complete a study of toxic air pollution from mobile sources, including both vehicles and fuels by May 15, 1992 and issue final air toxics regulations by May 1995. The study was to focus on air toxic emissions that posed the most significant risk to human health. EPA was delayed in completing the study and issuing air toxics standards. It is now under court order to propose regulations by April 2000, with a final rule by December 2000. It is likely EPA will propose stringent new air toxic standards for both conventional gasoline and reformulated gasoline (RFG) and EPA will issue these new toxics standards as part of its Integrated Urban Air Toxics Strategy. It is expected that EPA will focus on benzene in gasoline and is currently seeking information and data from industry in order to make a cost effectiveness determination of possible benzene control options.

SECRETARY RICHARDSON IS CORRECT NOT TO TAP THE STRATEGIC PETROLEUM RESERVE

NPRA commends the Secretary of Energy and the Administration for their continued disinclination to tap the Strategic Petroleum Reserve (SPR). The SPR is a designed to be available in major supply emergencies when our national security and economic prosperity are at stake. It is a strategic asset intended to counteract severe crude oil supply disruptions such as occurred during the 1970s.

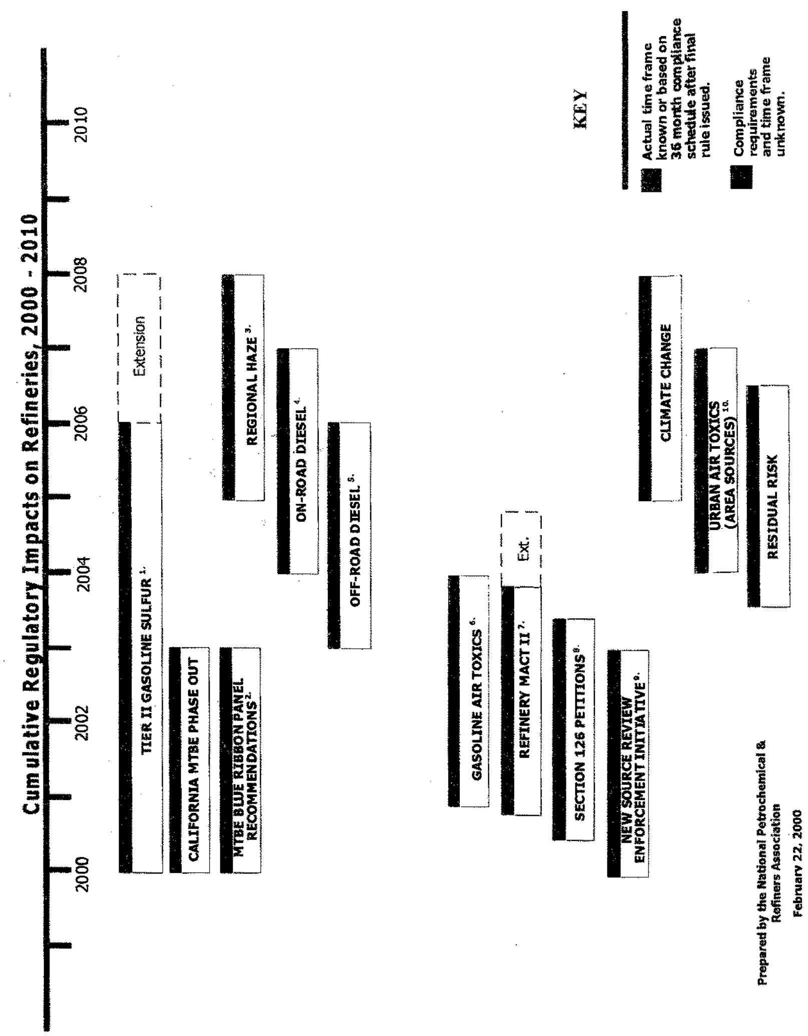
Use of the reserve should be based only on a Presidential finding that implementation of a drawdown plan is required by a disruption, originally stipulated by the Energy Policy and Conservation Act of 1975. The concept of using the reserve to influence prices should be rejected as impractical. Using the SPR to manipulate prices would both politicize this asset and render it less useful for the purpose for which it was originally designed. In addition, logistically, by the time the SPR crude oil was released, transported, refined and delivered to customers, the current situation and certainly the winter season would be over.

FUTURE STEPS

NPRA and its members urge federal and state policymakers to review the current situation and events leading up to it for ways to avoid or at least minimize the possibility of future price and supply upsets. Unless there is rational, coordination of pending and future regulations there is a serious threat of supply disruption and price swings. As was mentioned earlier, this can in part be accomplished by rethinking the current U.S. policy regarding production of crucial energy products such as heating oil, diesel and gasoline. We also support the Administration's attempts to urge OPEC and other suppliers of crude oil to consider providing additional allocations of oil to U.S. markets. Renewed international economic growth coupled with continuing strength of the U.S. economy may warrant increased crude oil supplies. Consequently, refiners may need access to more crude oil in order to meet projected strong demand for gasoline during the upcoming driving season. We also need to guard against a repeat problem with heating oil supplies if untimely "cold snaps" occur during the next and subsequent winters. Finally, as a nation, we must work to promote and develop policies that focus on continued environmental progress without reducing the supply of petroleum products needed for a healthy economy.

CONCLUSION

In the past decade the refining industry invested more money in environmental improvements than the total book value of refining assets. We have been asked to continue significant environmental investments, and we will do so. We ask, however, that policymakers pay close attention to the scope and pace of environmental regulations. Trying to go too far too fast will result in market disruptions which are not in the best interests of consumers or refiners. We hope that the Congress will assist us in addressing these concerns. NPRA believes that even with its occasional (but temporary) shortcomings, market forces remain the best foundation for U.S. energy policy.



Cumulative Regulatory Impacts on Refineries, 2000 - 2010
2000
2002
2004
2006
2008
2010
TIER II GASOLINE SULFUR 1.
Extension
CALIFORNIA MTBE PHASE OUT
MTBE BLUE RIBBON PANEL RECOMMENDATIONS 2.
REGIONAL HAZE 3.
ON-ROAD DIESEL 4.
OFF-ROAD DIESEL 5.
GASOLINE AIR TOXICS 6.
REFINERY MACT II 7.
Ext.
SECTION 126 PETITIONS 8.
NEW SOURCE REVIEW ENFORCEMENT INITIATIVE 9.
CLIMATE CHANGE
URBAN AIR TOXICS (AREA SOURCES) 10.
RESIDUAL RISK
KEY
Actual time frame known or based on 36 month compliance schedule after final rule issued.
Compliance requirements and time frame unknown.
Prepared by the National Petrochemical & Refiners Association
February 22, 2000

FOOTNOTES:

1. Longer compliance time for small refineries in some mid-western and western states and small refineries covered by SBREFA.

2. Specific actions in response to recommendations and compliance dates unknown. Time frame estimated.

3. Regional haze SIPs due 2005-2007. Earliest compliance date. Schedule may be impacted by NAAQS litigation.

4. EPA has indicated implementation by 2007. NPRM expected in Spring 2000.

5. EPA has indicated implementation by 2006

6. CAA Section 202 (l) final rule expected December 2000. Estimated compliance date 36 months later.

7. Compliance date may be harmonized with Tier II schedule.

8. Section 126 petitions (NO_X emissions) reflected because NO_x SIP call program is subject to a court-ordered stay.

9. Based on EPA statements to press. Estimated date for implementation.

10. Urban Air Toxics Strategy includes controls for gasoline distribution and oil and gas production sources. Estimated compliance schedule.

Mr. BARTON. Thank you, Mr. Slaughter. We have a pending series of votes on the floor, we have two votes. So, what I am going to try to do is let Mr. Farruggio and Mr. D'Arco give your testimony. Unfortunately, I don't think we're going to be able to give you oral questions, unless you want to wait around until 4 or something, and I doubt that you're going to want to do that. So, we'll hear from Mr. Farruggio, Mr. D'Arco, and then we'll release the panel and send you written questions.

We'll, also, try to do an informal brown bag seminar, like we've done in the past. So maybe if you, personally, can't come, somebody from your associations can come and members can come in and we can have an off-the-record discussion, because I would really like to spend some time. Unfortunately, these votes are going to make that impossible. So, Mr. Farruggio, and then we'll hear from Mr. D'Arco.

STATEMENT OF SAMUEL FARRUGGIO

Mr. FARRUGGIO. Thank you, Mr. Chairman. I am Sam Farruggio, President of Farruggio Express. I want to thank you for allowing me to testify before this subcommittee on diesel fuel crisis that is devastating my industry. I would, also, like to express a special thanks to Representative Greenwood for allowing me to share my thoughts.

Farruggio Express runs over 100 trucks in the northeast, operating out of five terminals located in Baltimore; Harrisburg; Allentown; Bristol, Pennsylvania; and Cliftwood, New Jersey. We, together with our independent contracts, total over 175 people counting on Farruggio to provide a living for our families.

My purpose today is to express my concerns for the industry I've worked in for 30 years. I am here to represent everyone from the independent truck owner, to the largest fleet owner, in what has become a battle to survive. Before I go into specifics on how the diesel fuel crisis has severely impacted by company, let me give you a little background on the trucking industry.

Trucks haul nearly every commodity in the United States. Essentially, if you bought it, a truck delivered it. There are over 9.6 million people employed in the industry today. Trucks haul 60 percent of the annual freights or tonnage. Eight-one cents out of every dollar spent on transportation goes to trucking. An astonishing 70 percent of the communities in the United States get their goods solely from trucks. The truck industry—the trucking industry is primarily composed of small businesses. Out of the hundreds of thousands of trucking companies running in the country today, 80 percent of them operate 20 or fewer trucks. These are companies that can be wiped out from this unbelievable surge in fuel costs.

According to the American Trucking Association, on average, trucking companies have profit margins of only two to 4 percent. So as diesel fuel prices jumped over 50 cents a gallon in the last year, most small trucking companies have seen their profit margins go from the average of two to four, to nothing. In fact, many small carriers are losing money on each and every load they deliver.

Behind labor, fuel is typically the second most important input for the trucking operation. As diesel fuel prices rose from an average of 96 cents a gallon a year ago, an average of $1.49 today, many of my colleagues and competitors have had to—had difficult times in keeping their trucks on the road. I know many are now at the breaking point. If the industry does not see some relief now, there will be significant numbers of carriers going out of business. This will be detrimental to our economy.

To put some perspective on just how serious the situation is, let me tell you what my company has gone through recently, by comparing February 1999 fuel costs, to those of February 2000. In February 1999, we consumed 50,000 gallons of diesel fuel, with an average cost of $1.04 a gallon, totaling for $52,000. In February of 2000, we purchased the same number of gallons, 50,000 gallons, but with an average price of $1.82 per gallon. It's a monthly cost of $91,000. The increase was $39,000 in 1 month. We traveled the same mileage, delivered the same product, costs us $39,000 more to do it.

Farruggio is a family owned and operated business that was opened over 80 years ago by my grandfather. We have survived many a crisis in the past and I feel confident we will see our way through this current situation. But, as in the past, I can guarantee that many other companies, some small and some larger, will not make it. Over the past 2 months, we have seen many independent contractors go out of the business. We're already in a period of a driver shortage, but after years within the industry, these drivers are forced to look for other types of work.

A good friend of mine in Allentown operates nine trucks. He is $15,000 behind in his payment to his fuel supplier. He will be forced out of business, unless we can make something happen to correct this injustice.

The independent contractors have shown their frustration. Recently, they have shut down the ports of New York, New Jersey, Philadelphia, Baltimore, and Miami, at various times. We have seen the fuel price increase as much as 15 cents in 1 day. Some days, the pump prices change three times. What will you do to correct this? You cannot act fast enough.

The current Department of Energy's statistics for the central Atlantic region shows the average fuel price at $1.60. Yet, in Philadelphia, the pump price is $1.79 to $1.89. Why is there such a large difference?

The diesel fuel crisis is a disaster to the trucking industry. The government reacts over night to most natural disasters; yes, we are in the third month of this crisis. The news media says the U.S. economy is controlled by the Federal Reserve. I beg to differ, at this point. I fear that it will take the country coming to a complete stop before we see some relief.

Most food stores hold three to 4 days supply. When there is not a loaf of bread in the store, not a gallon of milk for miles, and not nearly enough truck drivers to——

Mr. BARTON. I hate to interrupt you, Mr. Farruggio, but I've got 6 minutes to vote——

Mr. FARRUGGIO. Okay.

Mr. BARTON. [continuing] and I still need to let Mr. D'Arco——

Mr. FARRUGGIO. We thank you for this opportunity.

[The prepared statement of Samuel Farruggio follows:]

PREPARED STATEMENT OF SAM FARRUGGIO, PRESIDENT, FARRUGGIO'S EXPRESS

Mr. Chairman and Members of the Subcommittee, I am Sam Farruggio, President of Farruggio's Express in Bristol, PA. I sincerely appreciate the opportunity to testify before this subcommittee on the diesel fuel crisis that is devastating my industry. I would also like to to express a special thank you to Representative Greenwood for allowing me to share my thoughts. Farruggio's Express runs over 100 trucks in the Northeast operating out of 5 terminals located in Baltimore, MD, Harrisburg, PA, Allentown, PA, Bristol, PA and Cliffwood, NJ. We, together with our independent contractors, total over 175 people counting on Farruggio's to provide a living for our families. My purpose today is to express my concerns for the industry I have worked in for 30 years. I am here to represent everyone from the independent truck owner to the largest fleet owner in what has become a battle to survive.

Before I go into the specifics of how this diesel fuel crisis has severely impacted my own company, let me give you a little background on the trucking industry. Trucks haul nearly every commodity in the US. Essentially, if you bought it, a truck delivered it. There are over 9.6 million people employed in trucking related jobs in every sector of the economy. Trucks haul 60% of the freight tonnage annually. Eighty-one cents out every dollar spent on freight transportation goes to trucking. An astounding 70% of the communities in the US get the goods they consume solely from trucks.

The trucking industry is primarily composed of small businesses. Out of the hundreds of thousands of trucking companies running in this country, 80% of them operate only 20 or fewer trucks. These are the companies that can be wiped out from this unbelievable surge in fuel costs. According to the American Trucking Associations, on average, trucking companies have profit margins of only 2% to 4%. So, as diesel fuel prices jumped over 50 cents per gallon in the last year, most small trucking companies have seen their profit margins go from the average 2% to 4% to nothing. In fact, many small carriers are losing money on each and every load they deliver.

Behind labor, fuel is typically the second most important input for a trucking operation. As diesel fuel prices rose from an average of 96 cents per gallon a year ago to an average of $1.49 per gallon today, many of my colleagues and competitors have had a difficult time keeping their trucks on the road. I know many are now at the breaking point. If this industry does not see some relief now, there will be a significant number of carriers going out of business. This would be detrimental to our economy.

To put some perspective on just how serious this situation is, let me tell you what my company has gone through recently by comparing our February 1999 fuel costs to that of February 2000. In February of 1999, we consumed 50,000 gallons of diesel fuel with an average cost of $1.04 per gallon totaling $52,000.00. In February 2000, we purchased the same number of gallons, 50,000, but the average price was $1.82 per gallon for a monthly total cost of $91,000.00. This means that there was a $39,000.00 increase or 57%.

Farruggio's Express is family owned and operated business that was opened over 80 years ago by my grandfather. We have survived many a crisis in the past and I feel confident that we will see our way through this current situation. But, as in the past, I can guarantee that many other companies, some smaller and some larger, will not make it. Over the past two months, we have seen many independent contractors go out of business. We are already in a period of driver shortage, but after years within the industry, these drivers are forced to look for other types of work. A friend of mine in Allentown operates 9 trucks. He is $15,000.00 behind in payments to his fuel suppliers. He will be forced out of business, unless we can make something happen to correct this injustice. The independent contractors have shown their frustration by refusing to handle cargo, literally shutting down the ports of NY, NJ, Philadelphia, Baltimore and Miami at various times over the past few weeks

We have seen the fuel prices move as much as 15 cents in one day. We have seen changes at the pump two to three times in one day. What will you do to correct this? You can not act fast enough. The Current Department of Energy weekly statistics for the Central Atlantic region showed an average fuel price $1.601, Yet, in Philadelphia, PA, the price at the pump was from $1.799 to $1.899. Why is there such a large difference?

This diesel fuel crisis is a disaster to the trucking industry. The government reacts overnight to most natural disasters, yet we are in the third month of this crisis. The news media says that the US economy is controlled by the Federal Reserve. I beg to differ at this point. I fear that it will take the country coming to a complete stop before we see some relief. Most food stores hold a three to four day supply. When there is not a loaf of bread in the store, not a gallon of milk for miles and not nearly enough trucks nor drivers to catch up, then will we receive some assistance? When the movement of goods has ceased, our economy will come to a halt. We need your help now. What can you do to help these people who have or may lose everything? What can you do to save 9.6 million jobs?

There is no guarantee that my industry will see relief anytime soon. Diesel stocks are extremely low. In fact, they are 30% lower than one year ago. Even the Department of Energy has stated that we are not out of the woods. I am not an expert on how to achieve the relief that this industry needs, whether it be by releasing oil from the Strategic Petroleum Reserve or by some other means. All I know is that we desperately need your help. I am saying this not only as a very concerned trucking company, but as a consumer of the thousands of goods that these trucks deliver every second of the day across this entire nation. Again, we need your help and we need it now. I thank you Mr. Chairman and would be happy to entertain any questions.

Mr. BARTON. Thank you, sir. Mr. D'Arco, on behalf of the distributors.

STATEMENT OF PETER D'ARCO

Mr. D'ARCO. Thank you, Mr. Chairman and committee members. I am Peter D'Arco. I am the Vice President and Chief Operating Officer of S.J. Fuel Company. We're a third generation company, located in Brooklyn, New York, and deliver fuel to nearly 5,000 locations. Earlier this year, dealers from Staten Island and Brooklyn visited Congressman Fossella, to discuss the heating oil situation. Today, I'll try to describe the retailer perspective on the price increases and offer some suggestions.

I would like to join the chairman and other members in expressing concern for consumers. The high prices and cold weather that occurred earlier this year are troubling. Fortunately, prices are returning to more normal levels throughout the northeast and these price increases should have a limited impact on my customers.

Late January and early February were very trying times for my company and myself. As the temperature dropped, we had to pick up the pace of the company and nearly all of my employees began working extended hours, many had to work 7 days a week to keep up with increased demand. a price run up like this is a disaster for my company. Over time, expenses skyrocketed, credit lines have been stretched, and many consumers have delayed payments. Consumers of heating oil are upset by the increased prices, but the committee should know that throughout the 1990's, we have provided superior services and low prices. I hope that my customers will bear with me, as we move forward, and not forget the very low competitive prices that they have been getting for years.

In my discussions with other dealers and suppliers, it became apparent that there are two main reasons for this problem: low inventories and a backwardized market. Backwardization is illustrated by this example. If you buy a gallon of oil for a dollar today, the market is saying that if you sell it in the future, you will receive less than a dollar. Taking on inventory in a backwardized market means that you have high priced inventory and most certainly will sell it at a loss. The market did not provide incentives to keep inventory.

Several other important events happened. The weather became extremely cold and stayed extremely cold for several weeks. This led to a rapid increase in demand. Further, in the northeast, there are many interruptible consumers of natural gas. When the weather gets cold, many of these large gas consumers are switched to oil, thus the demand not only increased among our normal customer group, we added many new, but temporary customers. For my company, our volume in the Bronx increased over 400,000 gallons, as we began supplies city schools, hospitals, and colleges. This is an increase of 30 percent.

I would like to describe some of the bright spots. First, we took care of our customers and made sure they stayed warm, despite tight conditions. Second, our government agencies responded effectively. LIHEAP funding was released, so that low income families would not go without heat. The Department of Transportation issued emergency waivers to the hours of service regulations. The Coast Guard acted quickly to keep the water ways free of ice. The Department of Energy worked with the Small Business Administration, to develop and publicize bridge loans for heating oil retailers.

As we move away from the crisis, we would encourage this committee to carefully consider ways of minimizing this type of problem. I would like to offer a number of suggestions. The Petroleum Marketer's Association of America would recommend that legislation be enacted, ensuring that the depreciation period for tanks is 5 years. Representative Crane has introduced a bipartisan bill to accomplish this, H.R. 2429, and we would encourage the House to enact this measure.

The best way to have markets work is to have informed consumers, making intelligence choices on how to heat their water and their homes. Consumers, who use energy efficient equipment, will help reduce the cost of their energy bills every year. The Senate has enacted legislation——

Mr. BARTON. If you could summarize in the next 1 minute, I'd really appreciate it. I know you've got a lot and you waited a long time.

Mr. D'ARCO. That's quite all right. I just thank you for the opportunity——

Mr. BARTON. You've still got a minute, so——

Mr. D'ARCO. Well, okay. The Senate has enacted legislation, S. 348, which would provide consumers with this information and would, also, authorize funding to develop new technologies. The heating oil industry has vigorously supported S. 348 and H.R. 380 for several years, and would encourage all members of the subcommittee to support this bill. PMAA, also, believes that more and better information regarding oil markets can be provided by the Department of Energy. We believe that H.R. 3662 may be meritorious and should be considered by the committee. PMAA would, also, encourage the Congress to provide funding for oil heat research and development. The PMAA would recommend that funding of $1.2 million be provided for this program in fiscal year 2001.

PMAA, also, believes that the markets and the control that OPEC has over consumers in America results from a lack of domestic production and increase refining course in the United States. Congress should encourage domestic production of new crude oil reserves. Additionally, Congress should closely examine the efforts of the Environmental Protection Agency, to alter the sulphur levels in diesel fuel. These changes may result in additional supply and price problems.

Thank you for the opportunity to testify.

[The prepared statement of Peter D'Arco follows:]

PREPARED STATEMENT OF PETER D'ARCO, VICE PRESIDENT, S.J. FUEL COMPANY, ON BEHALF OF THE PETROLEUM MARKETERS ASSOCIATION OF AMERICA

Thank you Mr. Chairman and committee members. I am Peter D'Arco and I am the Vice President and Chief Operating Officer of SJ Fuels. We are a third generation company located in Brooklyn New York and deliver fuel to nearly 5000 locations. Earlier this year, dealers from Staten Island and Brooklyn visited Mr. Fossella to discuss with him what was going on in the industry. I am pleased that the Chairman felt that the entire subcommittee should be similarly briefed. PMAA represents heating oil retailers throughout the country, as well as distributors of gasoline and heating oil. Today, I will describe the retailer perspective on the price increases and offer some suggestions on what can be done to avoid a repetition of the extreme price increase of January and February.

Before beginning I would like to join the Chairman and other members in expressing concern for consumers. The high prices and cold weather that occurred earlier this year will affect many of the working poor and middle class who lack excess disposable income. Fortunately, prices have returned to more normal levels throughout the northeast and the last couple of warm weeks have allowed the industry to recover. Thus, the price increases should have a limited long term impact on heating oil consumers.

As you can imagine, late January and early February were very trying times for my company and me. I know my experience was not unique. First, as the temperature dropped, we had to pick up the pace at the company, and nearly all of my employees began working round the clock, and many had to work seven days a week to keep up with the increased demand. This was coupled with rapidly increasing costs which significantly stretched the credit lines of my business and many similarly situated businesses. Finally, there were many unhappy customers, and we had to spend a lot of time explaining the situation to them.

As you can imagine, a price run up like this is a disaster for my company. Expenses associated with overtime skyrocketed, my lines of credit have been stretched, and many consumers have delayed payments. Additionally, because of lack of product in the market, we occasionally had to deliver fewer gallons to individual homes so that we could provide product to all our customers. These ″short deliveries″ significantly reduced delivery efficiencies.

Consumers of heating oil are upset by the increased prices. However, throughout the 90's we have provided superior services and prices. The lower cost of heating oil in New York has been shown by the statistics developed by Energy Information Administration and the New York State Energy Research and Development Administration. I hope that consumers do not change supplier or to another fuel based on a temporary price increase last month, but rather look at the last decade.

In my discussions with other dealers and suppliers, it became apparent that there are two main reasons that this crisis occurred. Low inventories and a backwardated market. Backwardization is a term used to describe what happens when the market perceives product prices will be lower in the future. For example, if you buy a gallon of oil for a dollar today, the market is saying that if you sell it in the future you will receive less than a dollar. In December and January the market was backwardated at the crude level as well as the product level. Taking on inventory in a backwardated market means that you have high price inventory, and will almost inevitably lead to losses.

The result of this behavior is lean inventories. And unfortunately, as inventories become lean, there is a greater chance of price volatility as there is a limited amount of supply in storage to meet demand.

As the inventories became lean, a confluence of events occurred. First, the weather became extremely cold and stayed extremely cold for several weeks. While this winter has not even been as cold as normal, the latter half of January and the first weeks of February were far colder than normal. This led to a rapid increase in demand. Further, in the northeast, there are many interruptible consumers of natural gas. When the weather gets cold, many of these large commercial and industrial gas consumers were switched to oil. Thus, the demand not only increased among our normal customer group, we added many new, but temporary, customers. The Department of Energy is now studying this issue, and we are looking forward to their analysis as to how we can work with these industrial users to minimize their impact on our traditional customers.

What happened on the supply side has also now been described to the industry by the press and our suppliers. Apparently, there were a number of refinery problems that prevented normal production in the critical winter months reduced supply.

There are a few bright spots that did come out of this crisis. First, we took care of our customers and ensured that they received product, despite tight conditions. Second, it is our opinion that our government agencies responded effectively. LIHEAP funding was released so that low-income families would not go without heat. The Department of Transportation issued emergency waivers to the hours of service regulations. The Coast Guard acted quickly to keep the waterways free of ice for the heating oil barges on the Hudson River and other waterways in the northeast. The Department of Energy worked with the Small Business Administration to develop and publicize bridge loans for heating oil retailers.

As we move away from the crisis, we would encourage this committee to carefully consider legislation which might lessen the impact of the volatile oil markets on consumers in the northeast. I would like to offer a number of suggestions that have been discussed in our industry. We believe that we should take steps to improve the tax structure for those of us in the industry that store product. As you know, the regulations issued by the Environmental Protection Agency and state and local agencies discourage storing product. As a result, there have been sharp reductions in storage capacity in the northeast and throughout the country. Thus, when the weather turns colder there is less available oil in the market for distribution. As a result, spot prices drive the market, rather than the prices of stored product. To encourage the construction of storage, PMAA would recommend that the tax code be amended to provide economic incentives for storing petroleum products.

Currently there is discussion regarding the appropriate depreciation schedule for aboveground storage tanks. If they are classified as personal property, the depreciation period is five years, if real property, the depreciation schedule is 15 years. PMAA would recommend that legislation be enacted ensuring that the depreciation period is five years. Representative Crane has introduced a bipartisan bill to accomplish this, H.R. 2429, and we would encourage the House to enact this measure.

PMAA would also recommend considering the use of the investment tax credit as a method to encourage construction of new tanks.

PMAA also believes that the best way to have markets work is to have informed consumers that make informed and intelligent choices on how to heat their water and their homes. Consumers by making wise purchasing decisions and utilizing energy efficient equipment will help reduce the cost of their energy bills and reduce our reliance on imported energy. The Senate has enacted legislation, S. 348, which would provide consumers with this information and would also authorize funding to develop new technologies. A similar bill passed the House in 1998, and we would encourage this committee to consider S. 348 expeditiously. We believe this bill will provide the industry with tools to ensure consumers are using modern and efficient equipment and taking steps to maintain their equipment at the highest efficiency levels. Further, this bill provides the funds necessary to validate the energy efficiency of products and maintenance techniques, which should aid consumers. I have vigorously supported both S. 348 and its companion bill, H.R. 380, for several years and would encourage all members of the subcommittee to support this bill.

PMAA also believes that more and better information regarding oil markets can be provided by the Department of Energy. Each year PMAA hosts a conference where international oil markets are discussed, additionally PMAA participates in the Department of Energy's Winter Fuels Conference. However, we believe that improved information dissemination would have lessened the impact of the crisis. We believe that H.R. 3662 may be meritorious and should be considered by the Committee.

Maintaining waterways has been a traditional function of the Coast Guard. Prior to the crisis, there was concern that the Coast Guard would not have adequate resources to ensure waterways in the northeast were open. The Coast Guard responded admirably as the weather became severe and they should be commended. We would encourage the Congress to review the Coast Guard's equipment and operating abilities for future crisis.

PMAA would also encourage the Congress to provide funding for oilheat research and development. For many years, the Department of Energy has provided $1 million for energy research and development for oilheat consumers. This research has been the foundation for the development of new equipment and better service. Over time, this research has improved the efficiency of oilheat equipment. Additionally, a curriculum has been developed to educate service personnel on how to reduce oil consumption. In recent years, the funding has been reduced, and in the 2001 budget request no funding has been requested for this program. Thus, the 14 million households that use oilheat in the northeast do not benefit from the nearly $100 million that the Department of Energy invests in research. PMAA would recommend that funding of $1.2 million be provided for this program in FY 2001.

In addition to these ideas, there are several initiatives being considered to increase the amount of stored oil in the northeast. PMAA believes that objective is worthwhile, but is concerned that these measures may not achieve their objectives of increasing supply and minimizing price volatility. Therefore, we encourage the Congress to defer a decision on those matters until the Department of Energy completes a full analysis of this winter's problems and the possible impacts of the proposed initiatives on improving the supply situation. We must ensure that the remedy we select directly benefits the oilheat consumer.

PMAA also believes that the tight oil markets and the control that OPEC has over consumers in America results from a lack of domestic production and increased refining costs in the United States. We believe that the Congress should carefully consider legislation that would encourage domestic production of new crude oil reserves. Additionally, we would encourage the Congress to more closely examine the efforts of the Environmental Protection Agency to alter the sulfur levels in diesel fuel. PMAA is very supportive of the Agency's efforts to improve the fuel by reducing sulfur. However, the contemplated levels are likely to reduce refinery capacity below acceptable levels. Additionally, there is now consideration of adding a third diesel fuel which would reduce transportation efficiencies and likely reduce the amount of diesel and heating oil in the market.

I thank you for this opportunity to testify.

Mr. BARTON. Thank you, Mr. D'Arco. I really do apologize to this panel, that we can't really ask you a lot of questions, because I think you would be very illuminating. We will provide those questions for the record. This is not the only thing this subcommittee is going to do. We're going to be working with the Senate. We work with the administration. And we may do another hearing on this. We may move to do some sort of a working group that we put together on a bipartisan basis.

I do want to thank you for your testimony. Before I close the hearing, I want to, also, put on the record that the Air Transport Association, the Interstate Natural Gas Association, the Natural Gas Supply Association, and the Owner/Operator Independent Service Associations asked to testify. As you can tell, we ran out of room at the table, but their statements, if they give them to the committee in the requisite amount of time, will be included in the formal hearing record.

Thank you. You are released and the hearing is adjourned.

[Whereupon, at 3:10 p.m., the subcommittee was adjourned.]

[Additional material submitted for the record follows:]

PREPARED STATEMENT OF THE AIR TRANSPORT ASSOCIATION OF AMERICA

Mr. Chairman, the Air Transport Association of America appreciates the opportunity to submit this statement on the price fluctuations in oil markets.

ATA's member airlines collectively account for approximately 95 percent of the revenue passenger miles and freight ton-miles flown in the United States. With fuel representing our second largest item of operating expense, the recent fuel price run up is particular cause for concern in the airline industry.

Scope of the problem

Like home heating oil customers, motorists, and truckers, the airline industry is suffering from spiraling fuel price increases. The March 1, 2000 vs. March 1, 1999 spot market jet fuel price increase is 169%, from 31 to 83.25 cents per gallon. On an annualized basis this amounts to a $10 billion fuel cost increase, more than doubling the cost of fuel purchased by the airlines in 1999.

But far greater impact from the fuel cost increase falls on our customers and employees. For example, even if the average fuel price for all of 2000 were 75 cents per gallon, air carriers would need to increase fares by $32.50 just to cover these fuel cost increases. For many passengers, particularly leisure travelers, a $32.50 fare increase for each ticket is the difference between making a trip and staying home. Based on traditional elasticity measures in the industry, a $32.50 fare increase, would result in about 50,000,000 fewer enplanements, or 18,000,000 passengers foregoing trips. With 18,000,000 fewer passengers, airlines would be significantly overstaffed, and roughly 30,000 jobs would be expendable. Such a scenario also would result in service on marginally profitable routes—often to smaller communities—being dropped, further exacerbating adverse economic conditions in these communities.

The airlines, their customers, and their employees cannot afford the effects of these fuel price increases. The US economy cannot afford these types of increases either. The last time we faced this kind of devastating energy price increase, in 1990 and 1991, almost half the airline industry filed for protection under chapter 11 of the bankruptcy code, long standing airlines went out of business, more than 100,000 employees lost their jobs, and the industry went into a financial tailspin from which it took years to recover.

Congress needs to take action now to alleviate the crushing burden.

Energy Policy

The source of our problem is a national energy policy rooted in reliance on OPEC controlled crude oil. As long as oil supply, and therefore oil pricing, is dictated by OPEC, we remain at its mercy. International jawboning is not a substitute for energy policy. Cajoling, begging, and threatening foreign governments to produce more oil is not an energy policy worthy of the United States. And while targeted assistance to low income individuals who cannot cope with the price shocks is clearly understandable, it represents a failure to establish an enduring energy policy framework. Moreover, tax policies that burden oil consumers and disincentives to domestic oil production, are not the hallmarks of a sound energy policy.

ATA recommends both a short term and lone term course to alleviate the cost burden that falls so heavily on the US airline industry, and other oil dependent consumers.

Short term—As a modest demonstration of a national commitment to bringing oil prices down, the 4.3 cents per gallon "deficit reduction" tax adopted in 1993 must be repealed. This tax, which currently adds $620 million annually to the airlines' fuel cost burden made little sense when it was adopted and makes even less today in an era where there is no "deficit". Its immediate repeal will have both substantive and symbolic value. Averaged over the number of customers who fly, it amounts to an about $1 per passenger. But more importantly, it sends an important signal that discriminatory taxation is not the United States' tool of choice in dealing with energy.

Long term—The US must foster environmental and financial incentives for domestic oil exploration, production and refining. If even a small portion of our untapped reserves were made available for consumption, OPEC's stranglehold on the US economy would be lessened. Additionally, it makes little sense to beseech foreign governments to produce more oil while domestic reserves are so substantial.

Conservation Measures

Throughout the course of civil aviation, airlines have introduced fuel saving measures. We have done so well; in fact, there isn't much room for improvement in the current crisis. Changes in cruise speed, use of flight simulators, sophisticated flight planning systems, increasing load factors and the introduction of newer, more fuel efficient aircraft has resulted in improved fuel efficiency in excess of 130% since the first OPEC instigated fuel crises some 26 years ago. We currently obtain the equivalent of 38 miles per passenger gallon, a figure that compares favorably with even the most fuel-efficient automobile.

But there are only so many efficiencies that can be squeezed out.

It's time for the Government to develop a sound energy policy that serves the American people. It's time for the Government to develop an energy policy that shields the US from the overwhelming economic power of OPEC. And it's time that the government to develop an energy policy that looks to domestic solutions to our reliance on foreign sources of oil. Regrettably, we may be a generation late in doing so.

In the meantime, the Air Transport Association urges the Congress to repeal the 4.3 cents per gallon "deficit reduction" fuel tax now! Punishing consumption of energy has no role in the a national energy policy.

PREPARED STATEMENT OF HON. GEORGE W. GEKAS, A REPRESENTATIVE IN CONGRESS FROM THE STATE OF PENNSYLVANIA

Mr. Chairman, thank you very much for permitting me to submit this statement for this important hearing. I regret that I am unable to appear in person. I want to express my sincere thanks for holding this hearing on price fluctuations in oil markets.

As you know, the price of oil in the United States, particularly the Northeast, has increased at an astounding rate over the last few months. Unfortunately, numerous predictions indicate that gasoline prices could climb to over $2.00 a gallon. This steep rise in oil prices may lead to inflation, and the accompanying severe consequences for our current robust economic growth.

The people of Pennsylvania have suffered because of the recent increase in heating oil and diesel fuel prices. As a member of Congress representing Central Pennsylvania, I am particularly concerned about this issue. Specifically, my district sits at a unique "crossroads" position in the eastern seaboard and is home to a significant warehousing/distribution and transportation companies.

Pennsylvania, like so many other states in the Northeast, also has a large population that is dependent on heating oil, this price increase has hit pensioned seniors on fixed incomes and families on tight budgets particularly hard.

As everyone on the committee knows, the reason for the recent increase in the price of heating oil and diesel fuel is that demand is high and supply is low. Unusually cold January weather increased demand significantly above that experienced in recent years.

On the supply side, a significant portion of the increase in the price of oil is the result of international events that are beyond the control of the Congress or the people of the United States. For example, OPEC has pursued a production quota among its member states that has had a dramatic effect on the price of oil. In order to raise global oil prices, OPEC has advised its member countries to cut production to a level that would sufficiently limit supplies in order to raise petroleum profits for member countries. Simply put, the OPEC cartel dictates world oil prices. Since January, OPEC has decreased its oil production by 4.2 million barrels a day from this time last year—about 13% lower than January 1998. As a result, a barrel of oil increased in price from $12.33 a barrel last year to nearly $31.00 a barrel at the close of trading yesterday. This price increase at the industry level has been passed directly on to consumers at gas stations, trucking companies, utilities and other fuel consumers, and has been felt throughout the economy.

OPEC's behavior illustrated by the recent rise in oil prices demonstrates the dangers of shutting down America's domestic oil production. However, this Administration has pursued policies that have increased our country's dependency on foreign oil, especially OPEC. For example, this Administration has continued to put unnecessary restrictions on oil exploration and extraction. While there are many untapped reserves in the U.S., restrictions that prevent companies from extracting this oil.

Mr. Chairman, today I would like to thank you for having the courage to investigate the dramatic increase in oil prices. I would also like to welcome to this hearing Samuel Farruggio, President of Farruggio Express Trucking, Inc., of Bristol, Pennsylvania. Although he is not a constituent of mine, his concerns about the effects of high oil prices are shared by people throughout Pennsylvania. Hard working entrepreneurs like Mr. Farruggio are among the hardest hit by these drastic price increases.

Thank you again Mr. Chairman for allowing me to submit this statement.

PREPARED STATEMENT OF HON. LAMAR S. SMITH, A REPRESENTATIVE IN CONGRESS FROM THE STATE OF TEXAS

Mr. Chairman, thank you for holding this important hearing on Price Fluctuations in Oil Markets. I appreciate the opportunity to submit testimony and regret that I cannot be present because of a Judiciary Committee meeting.

Our best defense against instability and volatility in the world oil market is an energy policy that produces a healthy domestic oil and gas industry. For too long, the Administration has pursued a policy of cheap foreign oil.

Domestic producers continue to recover from one of the worst price crashes in history. This has been followed by some of the highest oil prices in recent years. These wild fluctuations are not good for anyone.

The United States now imports 55 percent of our petroleum products, up from 45 percent in 1991, and just 35 percent in 1973. We are becoming increasingly dependent on foreign oil even though the Administration found, in 1995 and in a number of other years, that increasing oil imports is a threat to national security.

Rather than develop and implement a national energy policy, the Administration continues to rely on foreign oil. Most recently it sent Secretary of Energy Richardson to other oil producing nations to ask them to increase their output.

In particular, Iraq has benefited from the United States' dependence on foreign oil. The United Nations "Oil for Food Program" has enabled Iraq to rebuild its facilities and become the swing producer on the world market. Iraq's new market power leaves the United States even more vulnerable to the whims of Saddam Hussein.

Just over 1 year ago, when producers in the United States faced some of the lowest prices in history, the Administration did nothing. This industry lost over 65,000 jobs during the most recent downturn. The steel industry, which also faced tough times, lost about 10,000 jobs. In order to help the steel industry, the Administration proposed $300 million in tax incentives. Unfortunately the President vetoed the tax reform bill that included similar tax relief for the domestic petroleum industry.

Independent producers are the backbone of the industry. These wildcatters drill 85 percent of the wells and produce about 40 percent of the domestic oil. These risk takers typically plow most of their income back into the business, always looking for the next producing well. They are hardest hit by the boom and bust cycle since typically they do not have other operations on which to rely for cash flow.

The industry's infrastructure must be protected. When wells are shut in, that production is lost forever. Marginal wells, wells that produce less than 15 barrels a day, are particularly vulnerable to low oil prices. Individually these wells produce very little, however their aggregate oil production is 20 percent of our nation's total.

Oil production today is less than it was in 1986. In 1986 the United States produced about 8.5 million barrels a day and in 1997 that number dropped to below 6 million barrels a day. We need to enact policies that will increase our domestic production.

Many in Congress and the Administration continue to oppose opening some of our resources to oil and gas drilling. The Arctic National Wildlife Reserve (ANWR) holds the potential to lessen our reliance on imported oil. It is estimated that a small portion of the reserve could hold 16 billion barrels of oil.

Drilling is also banned off much of America's coasts, further limiting access to potentially large reserves. Without allowing, much less encouraging, domestic exploration and production we cannot hope to lessen our dependence on foreign oil.

Some in Congress want to tap into the Strategic Petroleum Reserve (SPR) to combat higher home heating oil and gasoline prices. I strongly oppose this action. The SPR has statutorily defined uses and manipulating markets is not one of them. The SPR was created for use during crude oil supply emergencies.

Congress should pass and the President should sign a number of oil and gas incentives to support the domestic industry. I support enacting a marginal well tax credit that will help keep these wells on line when prices drop. I support other tax relief provisions such as a percentage depletion expansion; clarification that delay rental payments are deductible as ordinary and necessary business expenses; and the expensing of geological and geophysical expenses among other things. Many of these provisions were included in last year's tax reform legislation that was vetoed by the President.

As we enter the next century we must develop a national energy policy that will reduce dependence on foreign oil and stabilize prices.